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Shareholder or Stakeholder Model of Corporate Governance: Which One Should Ethiopia Choose?

By

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Approval Sheet

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Acknowledgement

Writing this note of gratitude is the finishing touch on my thesis after a rigorous period of almost a year. It was a period of intense learning for me, both at educational and personal level. I would like to reflect on the people who have supported and helped me so much throughout this period.

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Abstract

In whose interests should a corporation be run? Should corporate governance focus on protecting the interests of only shareholders or should it expand its focus and consider the interests of other stakeholder groups? For decades, debate has been made on this question among scholars of corporate governance. Corporate governance literature commonly divides the world into two spheres: the Anglo-American "outsider" system and the continental Europe or German-Japanese "insider" system, each with a characteristic set of structural elements, ownership patterns, and strengths and weaknesses. The traditional "Shareholder Model", which predominantly exists in Anglo-America countries, argues that a firm should primarily focus on shareholders' wealth maximization. On the other side, the "Stakeholder Model", which exists in German, Japan and other Continental Europe, contends that a firm has other purpose in a society than maximization of shareholders wealth so that it should focus not only on the interests of shareholders but also on employees, customers, suppliers, local communities and other stakeholders. The purpose of this research paper is to introduce each model and the theoretical debate that exists between them with a final recommendation of the appropriate model for Ethiopia. It tries to evaluate both models generally and in light of Ethiopia's corporate governance environment. The paper recommends that Ethiopia should follow an eclectic approach in choosing between the two models which can be represented by the "Enlightened Shareholder Value" approach.

Introduction

Nowadays, corporate governance has become an issue that has a global significance. As a result of massive wrongdoings, corporate governance has become the focus of attention in the past decade.[1] Corporate governance failures have shown in varies companies which raised public demand for governance reform.[2] It is a well-accepted assertion that good corporate governance has a positive impact on firm performance and economic development.[3] Good Corporate Governance ensures a fair and transparent business environment by holding companies accountable for their actions.[4] On the other hand, corporate governance failures can undermine development efforts by misallocating much needed capital and resources.[5]

Obviously, companies are established by shareholders so that they generate profit for the latter. But, companies must address a fundamental question when they deal with that profit generation. That question is about the purpose they have in the society in which they operate. Are companies nothing but the private properties of the shareholders with no other duty than increasing value for their shareholders who created them? Or are they more than that having a responsibility to deal with the interests of the various stakeholders they are in touch with? The discussions and arguments surrounding these questions are not yet settled.

Two competing approaches exist on the purpose of a firm in a society.[6] The first one is the traditional 'shareholder model' which tries to argue that the purpose of a corporation is to promote shareholders' interest and value.[7] The second one, which is known as 'stakeholder model' asserts that the purpose of a corporation is to serve the wide range of interests beyond and including that of shareholders.[8] Another theory called "enlightened shareholder value

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1 Guosong Shao, Toward a Stakeholder Model of Corporate Governance: Evidence from U.S Media Companies, (2009, Unpublished, University of Alabama, Alabama), p.1

2 *Ibid*

3 Eric Hontz and Aleksandr Shkolnikov, Corporate Governance: The Intersection of Public and Private Reform, (Center for International Private Enterprise and United States Agency for International Development (USAID), 2009), p.7

4 M. Tarek Youssef, Corporate Governance: an Overview – around the Globe, Grant Thornton – Egypt, p.3. available at http://www.eiod.org/uploads/Publications/Pdf/Corp.%20Governance-1.pdf

5 Hontz and Shkolnikov, *Supra note 3*

6 Andrew Keay, "Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach", Sydney Law Review, Vol. 29: 577, p. 577 and 578

7 *Ibid*

8 *Ibid*

approach" came through time and states that the decisions of the board should consider the interests of relevant stakeholders and its impact on the community and environment, for the long term benefit of the company and its shareholders.[9]

These "shareholder" and "stakeholder" models of corporate governance have individuals or groups behind, who have conflicting interests: one urging investment return and profit, the other urging for some other social and environmental purposes. In addition to this, both models of governance have their own advantages and disadvantages which should be compromised in some way. So, the discussion of the issue includes the compromise that should be made between those conflicting interests and the pros and cons of the two models.

The paper is organized into four chapters. Accordingly, the first chapter is about the proposal of the study. It is concerned with a general background, the problems that the research tries to address, the objective of the study, the significance and scope of the study and the research methodology that will be employed in the study.

The second chapter deals with corporate governance in its general context and in Ethiopia. After a brief definitional introduction, it discusses the nature of corporate governance. A general overview of corporate governance in Ethiopia will also be dealt with. Nowadays, the issue of corporate governance has got much attention the reason for which will be dealt with in this chapter.

Chapter three discusses the major theories pertaining to corporate governance and the two competing models of corporate governance. It tries to explain both the so called "shareholder" and "stakeholder" models of corporate governance focusing on the characteristics which make one different from the other. The third approach, which is known as "enlightened shareholder value" approach, will be dealt lastly.

The final chapter is concerned with the main issue as to which one of the models should Ethiopia choose. It begins by making a brief comparison of the two models and later deals with the problems that each model contains. The corporate governance models of selected countries will

[9] *Ibid*

also be discussed in this chapter. Finally, the corporate governance model which should be followed by Ethiopia will be recommended.

CHAPTER ONE

1. Proposal of the Study

1.1 Background of the Study

The term "Corporate Governance" derives from an analogy between the government of nations or states and the governance of corporations.[10] This is why some people make such analogy taking in to account the various characteristics they share in common. In this regard, the former president of the World Bank, James Wolfensohn, asserted that the governance of corporations is now as important in the world economy as the government of countries.[11]

Corporate governance is defined and understood in different ways depending on the discipline, institution or author, country and legal tradition involved. The Cadbury Committee Report of 1992, which came up with what is known as the most widely used definition of corporate governance, defines it as *"corporate governance is the system by which companies are directed and controlled"*.[12] The Organization for Economic Cooperation and Development (OECD), which published its revised Principles of Corporate Governance in 2004, states the following with respect to corporate governance: "*Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.*"[13] The International Finance Corporation (IFC) also defines it as "*…the structures and processes for the direction and control of companies.*"[14]

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[10] Udo C. Braendle and Alexander N. Kostyuk, Developments in Corporate Governance, available at www.virtusinterpress.org,

[11] *Ibid*

[12] The Cadbury Committee Report on the Financial Aspects of Corporate Governance, (1992), p.15. *The Cadbury Committee was a committee chaired by Adrian Cadbury. The Committee was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange and the accountancy profession to address the financial aspects of corporate governance. The Committee produced the first Code of Best Practice on corporate governance, in 1992.*

[13] Organization for Economic Cooperation and Development (OECD) Principles of Corporate Governance, Revised Publication, (2004), p.11

[14] The International Finance Corporation Corporate Governance Manual, (2nd ed. 2010), BACSON, Hanoi, p.6

The history of corporate governance cannot be separated from the emergence of corporations. Corporate governance correspondingly extends back at least to the formation of the East India Company, the Hudson's Bay Company, the Levant Company and the other major chartered companies launched in the 16th and 17th centuries.[15] Corporate governance has existed since the use of the corporate form created the possibility of conflict between investors and managers.[16]

Until the beginning of the 17th century, the partnership was the dominant form for organizing jointly owned business firms.[17] The corporation, as we know it today, is the product of a process that began in England as early as the 17th century.[18] A research on the history of corporate governance shows that it has been essentially devoted to Anglo-Saxon large public corporations.[19] The corporations of the time were quite different from those of today and were quasi-governmental and closely watched by the Kings and the Queens.[20] Incorporation was a privilege which exists for public purpose and association and corporate status rights sprang from the church or the crown.[21]

The Emergence of industrialization in the 19th century transformed corporations from state-controlled organizations to unlimited private organizations with limited responsibility and accountability.[22] Share trading became easier and shareholders began to use the "exit" option to express their satisfaction or dissatisfaction rather than exercising their control via "voice" which was shifted to directors.[23] Towards the beginning of the 20th century, control of corporations shifted more and more into the hands of managers and the so called "agency problem" began to

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[15] Brian R. Cheffins, The History of Corporate Governance, (The European Corporate Governance Institute Working Paper No. 184/2012, University of Cambridge, 2012), p.1, available at: http://ssrn.com/abstract=1975404
[16] *Ibid*, p.1
[17] Braendle and Kostyuk, *Supra note 10*
[18] Braendle and Kostyuk, *Supra note 10*
[19] A. Naciri, Corporate Governance around the World, Routledge Studies in Corporate Governance, Routledge, (2008).
[20] Braendle and Kostyuk, *Supra note 10*
[21] John H. Farrar, "A Brief Thematic History of Corporate Governance", Bond Law Review, Vol. 11, Iss. 2, Article 9, (1999), p. 2. available at: http://epublications.bond.edu.au/blr/vol11/iss2/9
[22] Braendle and Kostyuk, *Supra note 10*
[23] Braendle and Kostyuk, *Supra note 10*

deepen.[24] In fact, it is this agency problem that necessitated the system of corporate governance.[25]

Corporate governance systems have evolved mostly as a response to corporate failures or systemic crises.[26] The South Sea Bubble in the 1700s, the stock market crash of 1929, the secondary banking crisis of the 1970s in the U.K., the U.S. savings and loan debacle of the 1980s, the 1998 financial crisis in Russia, the 1997-1998 financial crisis in Asia, the current global financial crisis which started in 2008 and other notable company failures are some of the reasons which brought some changes in the corporate governance systems. [27] Especially in the past decade, corporate governance has become the focus of attention as a result of massive wrongdoings.[28] Corporate governance failures have shown in various companies which raised public demand for governance reform.[29]

It is a widely recognized assertion that corporate governance can play an important role in improving corporate performance. Corporate governance increases the confidence of investors in the corporations and helps the betterment of business environment.[30] Well-governed and managed corporations attract huge investment, get cheaper loans and achieve their goals.

The recent economic crisis is claimed to have revived the old debate about whether companies should focus on their shareholders, customers or workers.[31] Various scholars have discussed the issue from different perspectives. Specially in the past decade, the role of stakeholders in a company has been a source of debate among two competing groups some of which argue that stakeholders have no claim on the enterprise other than those specifically set forth in law or

[24] Braendle and Kostyuk, *Supra note 10*

[25] Hussein Ahmed, "Reforming Corporate Governance in Ethiopia: Appraisal of Competing Approaches", Oromia Law Journal, Vol. 3, No. 1, p. 168

[26] International Finance Corporation*, Supra note 5,* p. 9

[27] International Finance Corporation*, Supra note 5*, p.10

[28] Shao, *Supra note 1*, p.1

[29] *Shao, Supra note 1,* p.1

[30] Hussein Ahmed, "Overview of Corporate Governance in Ethiopia: The Role, Composition and Remuneration of Boards of Directors in Share companies", Mizan Law Review, Vol. 6, No.1, (2012), p. 2

[31] The Economist, April 22, 2010, available at: http://www.economist.com/node/15954434

contract while others argue that companies fulfill an important social function, have a societal impact and, accordingly, must act in the broad interests of the society.[32]

The first one is the traditional "shareholder model" (also called "Anglo-American", "common law", "outsider model") which argues that the purpose of a corporation is to promote shareholders' interest and value. The shareholder theory, which was originally proposed by Milton Friedman, argues that the sole responsibility of a corporation is to increase profits.[33] This theory considers managers of a corporation as hired agents who are morally bound to work in the best interest of shareholders. Much of the traditional company law doctrine considers that corporations must be managed to promote, above all, shareholders' rights.[34] Activities in favor of non-shareholder constituencies such as suppliers, consumers, employees or the community at large can be perceived as a means of management to increase its power and personal prestige.[35] The shareholder model of corporate governance dominates especially in the Anglo-American corporate environment thus in countries like the US and UK. The main objective of US corporations is the maximization of shareholders' value.[36]

The second one, which is known as "stakeholder model" (also called "continental law", "German-Japanese" or "insider model") offers an alternative purpose of a firm and asserts that the purpose of a corporation is to serve the wide range of interests beyond and including shareholders. R. Edward Freeman was the original proposer of the Stakeholder theory.[37] His original concept was that managers have a moral obligation to consider and appropriately balance the interests of all stakeholders.[38] Stakeholder theory suggests that the purpose of a firm is to serve broader societal interests beyond economic value creation for the shareholders.[39] This

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[32] International Finance Corporation*, Supra note 14,* p.9
[33] Shareholder and Stakeholder Theories of Corporate Governance, (Corplay Blog, Posted by Corplay Admin, 2013), available at http://www.corplaw.ie/blog/bid/317212/Shareholder-Stakeholder-Theories-Of-Corporate-Governance
[34] Elena F Pérez Carrillo, "Corporate Governance: Shareholders' Interests' and Other Stakeholders' Interests'", Corporate Ownership & Control, Volume 4, Issue 4, (2007), p. 1.
[35]*Ibid*
[36] Michael Hoffmann, What are the Main Implications of "Shareholder" and "Stakeholder" Model of Corporate Governance for the Development of Long-Term Human Resource Strategies, (Seminar Paper, 2007).
[37] Saint and Tripathi, The Shareholder and Stakeholder Theories of Corporate Purpose, p.5
[38] *Ibid*
[39] *Ibid*

theory argues that a company owes a responsibility to a wider group of stakeholders, other than just shareholders and these stakeholders may include employees, customers, suppliers, creditors competitors and the society at large.[40] The stakeholder model is common in continental Europe, particularly in Germany and Japan. The primary goal of German companies is to balance the interests of a wide range of different stakeholder groups, such as employees, suppliers, customers and managers including that of shareholders.[41]

A third theory is recognized as "enlightened shareholder value" approach. This approach argues that it is with a long-run orientation that seeks sustainable growth and profits based on responsible attention to the relevant stakeholder interests that corporations should pursue shareholder wealth maximization.[42] According to this approach, "for the long term profit maximization of shareholders and sustainability of the company, the decisions of the board should align the interest of shareholders profit maximization with the interest of stakeholders".[43] It states that corporations should generate profit for their shareholders but only having regard to the long term impact of that profit generation.

The difference between shareholder and stakeholder models of corporate governance emanates, among others, from the ownership condition of the companies (concentrated vs. dispersed ownership). But, behind both models of governance, there are individuals/groups/institutions sometimes having conflicting interests: one urges for investment return and profit while the other urges for interests other than profit. In addition to this, both models of governance have their own advantages and disadvantage which should be compromised in some way.

So, the purpose of this research paper is to discuss and evaluate the two models of corporate governance. It tries to compare the two approaches and looks at the conflicting interests between them with a view of recommending the appropriate model of governance.

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[40] *Supra Note 33*
[41] Hoffmann, *Supra note 36*
[42] *Supra note 33*
[43] Gebeyehu Simachew, "Ethiopian Share Company Law In Light of OECD Principles of Corporate Governance", Abyssinialaw Blog, (2014)

1.2 Statement of the Problem

While implementing corporate governance mechanisms, corporations must address this fundamental question: should corporate governance focus on protecting the interests of only shareholders? Or should they go beyond that and consider the interests of other stakeholder groups? This, in effect, means a choice between a "shareholder" and "stakeholder" model of corporate governance. In the shareholder model, the maximization of shareholder value is the primary goal of the firm.[44] But the stakeholder model demands that a variety of firm constituencies such as employees, suppliers, customers, etc. have a say in the firm, and their interests should be balanced against each other in management decision-making.[45] This issue is being debated especially in recent times. The old shareholders approach to corporate governance is recently being criticized for its disregard of various stakeholders' interests and the long term profitability of a corporation.[46]

We find various scholarly articles on corporate governance in general and the shareholder/stakeholder model of corporate governance debate in particular. Some publications on corporate governance tend to show the recent debate between the two models and the growing significance of stakeholder model of corporate governance. There are also other publications in Ethiopia on issues of corporate governance and corporate governance models. Hussein Ahmed[47] Fekadu Petros,[48] Gebeyehu Simachew,[49] Minga Negash,[50] and Hussein Ahmed[51] (in a different article) are some of the writers who have research papers on corporate governance and related matters. These research papers discuss and evaluate the corporate governance status in Ethiopia

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[44] Christian Stadler et al, "The CEO's Attitude towards the Shareholder Value and the Stakeholder Model. A Comparison between the Continental European and the Anglo-Saxon Perspectives", Problems and Perspectives in Management, Vol. 4, Iss. 3, (2006), p.41

[45] *Ibid*

[46] *See,* for example, Joe Nocera, Down With Shareholder Value, The New York Times, Aug. 10, 2012 at http://www.nytimes.com, William A. Galston, 'Shareholder Value' Is Hurting Workers, The Wall Street Journal, Dec. 9, 2014, at http://www.wsj.com/ and The Economist, *Supra note 31*

[47] Hussein Ahmed, *Supra note 30*

[48] Fekadu Petros, "Emerging Separation of Ownership and Control, in Ethiopian Share Companies: Legal and Policy Implications", Mizan Law Review, Vol. 4, No.1, (2010)

[49] Gebeyehu Simachew, *Supra note 43*

[50] Minga Negash, Rethinking Corporate Governance in Ethiopia, (2008, Unpublished, University of the Witwatersrand, School of Accountancy)

[51] Hussein Ahmed, *Supra note 25*

from various perspectives. Few of them discuss corporate governance from shareholder-stakeholder perspective.

Those research papers which have made specific discussion of the approaches to corporate governance have some limitations. In the first place, only a birds-eye-view of the issue is presented without detailed discussion. The advantages and disadvantages of both models, the major differences and similarities, the specific circumstance on which both models are based and whether such circumstances exist in Ethiopia have not been adequately addressed. Secondly, what has been recommended for Ethiopia is to follow an eclectic approach and take the best out of both models of corporate governance. But what are those best practices to be adopted by Ethiopia from both models which take in to account the specific condition of the country is not touched upon at all.

So, this research paper will address the following issues related with the topic.

- What should be the purpose of a firm in the Ethiopian context?
- Among the so called shareholder and stakeholder models of corporate governance, which one best suits Ethiopia's condition?
- Whether decisions of the board of directors in Ethiopia should consider the interests of only the shareholders? Or should they also include the interests of other stakeholder groups?
- Would it be possible to compromise the pros and cons of adopting either of the two models of corporate governance and choose an appropriate form of governance model for Ethiopia?
- Whether Ethiopia should look for a third approach other than the "shareholder" and "stakeholder" models of corporate governance?
- What position should the existing amendment of the Ethiopian Commercial Code take among the "shareholder" and "stakeholder" models?

1.3 Objectives of the Study

Unlike share companies in the past which were formed among founders, there are a number of companies that are being formed by sale of shares to the wider public.[52] Related to this, there is a growing separation of ownership and control in those share companies which raises its own governance issues. There is also a current debate as to what should the role of corporate governance in a society be. So, this research paper makes an in-depth and closer look at the shareholder/stakeholder approach debates and tries to address issues that have not been addressed so far with a view to investigate the position of the Ethiopian corporate governance regime and proposing a suitable corporate governance model.

So, the main objectives of this research paper are:

(1) To explore the theoretical foundations and show the characteristics of the shareholder and stakeholder models.

(2) To show in which category of the models the Ethiopian corporate governance regime falls.

(3) To evaluate the pros and cons of the two models.

(3) To evaluate Ethiopia's condition in terms of adopting both models of corporate governance

(4) To recommend a suitable form of corporate governance model that fits Ethiopia's needs.

1.4 Significance of the Study

The study is expected to contribute much towards informing the forthcoming amendment of the Commercial Code and the overall development of corporate governance of the country in showing the available corporate governance models and recommending the one that is appropriate. Hopefully, it also helps legislatures, policy makers and investors. The other significance of the study is its contribution to the Ethiopian legal literature as a reference for educational institutions on company law and governance.

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[52] See Addis Fortune, April 28, 2011

1.5 Scope of the Study

The study focuses on the two major models of corporate governance, their characteristics, advantages and disadvantages and the governance model that Ethiopia should adopt for its corporate governance. It will also deal with the major theories pertaining to corporate governance.

Issues of corporate governance may touch various business organizations. But this research paper will be limited to corporate governance of publicly held share companies in Ethiopia whose shares are subscribed by many shareholders. This is mainly because it is share companies that are showing growing separation of ownership and control which in turn raises issues of corporate governance and agency problem.

1.6 Methodology

This research paper uses different primary and secondary sources. Concerning primary sources, the research refers and includes various domestic and foreign legislations dealing with corporate governance. With respect to secondary sources, the various books, journals, reports, guidelines and other materials on the topic are analyzed in search of arguments, reasons and justifications in choosing one form of governance over the other.

In addition to this, both descriptive and analytical methods of research are used in the study. Descriptive method is used because the research aims to describe concepts, circumstances and situations in detail. Hence, this legal research is mainly doctrinal research.

1.7 Limitations of the Study

One problem that limits the research is the absence of materials in relation to models of corporate governance at domestic level. Absence of enough domestic research materials on the issue has some impact on the research paper. In addition to this, the unfamiliarity of the issue to our country makes it harder to show the actual practice in relation to the idea. So, the writer tries to overcome these challenges by exhaustively analyzing and dealing with the available materials.

CHAPTER TWO

2. Corporate Governance in General and in Ethiopia in Particular

This chapter is about a general overview of corporate governance. It discusses corporate governance in its general context and in Ethiopia. It begins by dealing with the term "corporation" in the context of ownership and legal personality. It then explains the meaning and nature of corporate governance in light of share companies. Finally, it tries to see the status of corporate governance in Ethiopia by dealing with the background, the organs involved in the corporate governance and the role that each organ plays in the process.

2.1 Meaning of Corporation

Corporations are sophisticated tools of pooling capital together to venture in businesses that require large capital in a capitalist world.[53] The shareholders in a corporation usually elect or appoint the board of directors to supervise the activities of the corporation which is owned by the shareholders themselves. Despite this authorization, there is different and separate personality between those who own the corporation (shareholders) and the corporation itself. The purpose of this section, however, is not to explain what a corporation means. It is rather to explain a corporation in terms of legal personality.

The law perceives a corporation as a 'legal person' subject of rights and duties i.e. capable of owning real property, entering into contracts and suing or being sued in its own name.[54] When we think of a corporation having separate legal personality from those who own it, we have two types of ownership and legal rights independent of each other. The shareholders own the corporation and have some legal rights towards it while the corporation itself, as a legal person, owns the corporate assets and transacts with third parties. We have then two-tier of ownership in a given corporation.

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[53] Assefa Aregay, Corporate Governance Rules in Ethiopia and Germany: A Comparative Analysis, (2015, Unpublished, Central European University), p.1

[54] Katsuhito Iwai, What is corporation? The Corporate Personality Controversy and Comparative Corporate Governance, (2011, Unpublished, Faculty of Economics, University of Tokyo), p.3

The Black's Law Dictionary defines corporation in a way that reflects the separate legal existence of a corporation. According to it, a corporation is: *"An entity (usu. a business) having authority under law to act as a single person distinct from the shareholders who own it and having rights to issue stock and exist indefinitely…"*[55] The definition shows that though the shareholders own the corporation, it still has a distinct personality from them.

The separate personality of a corporation has been a subject of debate in what is known as a "corporate personality controversy". Two theoretical debates have emerged in this so called 'corporate personality controversy' which center on the essence of corporation: "corporate nominalism" and "corporate realism"[56]. The corporate nominalism contends that a corporation is a contractual association of shareholders whose legal personality is an abbreviated written name of its shareholders. [57] The corporate realism on the other hand asserts that a corporation is a full-fledged organizational entity whose legal personality is no more than the external expression of its real personality in the society.[58] In contrast to a firm owned by a single person, a corporate firm is composed of not one but two ownership relations- the shareholders own the corporation and the corporation in turn owns the corporate assets which shows that a corporation plays a dual role of 'a person' and 'a thing'.[59] The Black's Law Dictionary's definition of corporation reflects this two-tier ownership of a corporation expressed in the corporate realism theory.

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[55] Bryan A. Garner, Black's Law Dictionary, (8th Ed.), West a Thomson, (2004), p. 365
[56] Iwai, *Supra note 54*, p.3
[57] Iwai, *Supra note 54*, p.3
[58] Iwai, *Supra note 54*, p.3
[59] Iwai, *Supra note 54,* p.9

Generally, the two-tier ownership structure of a firm can be illustrated by the following figure.[60]

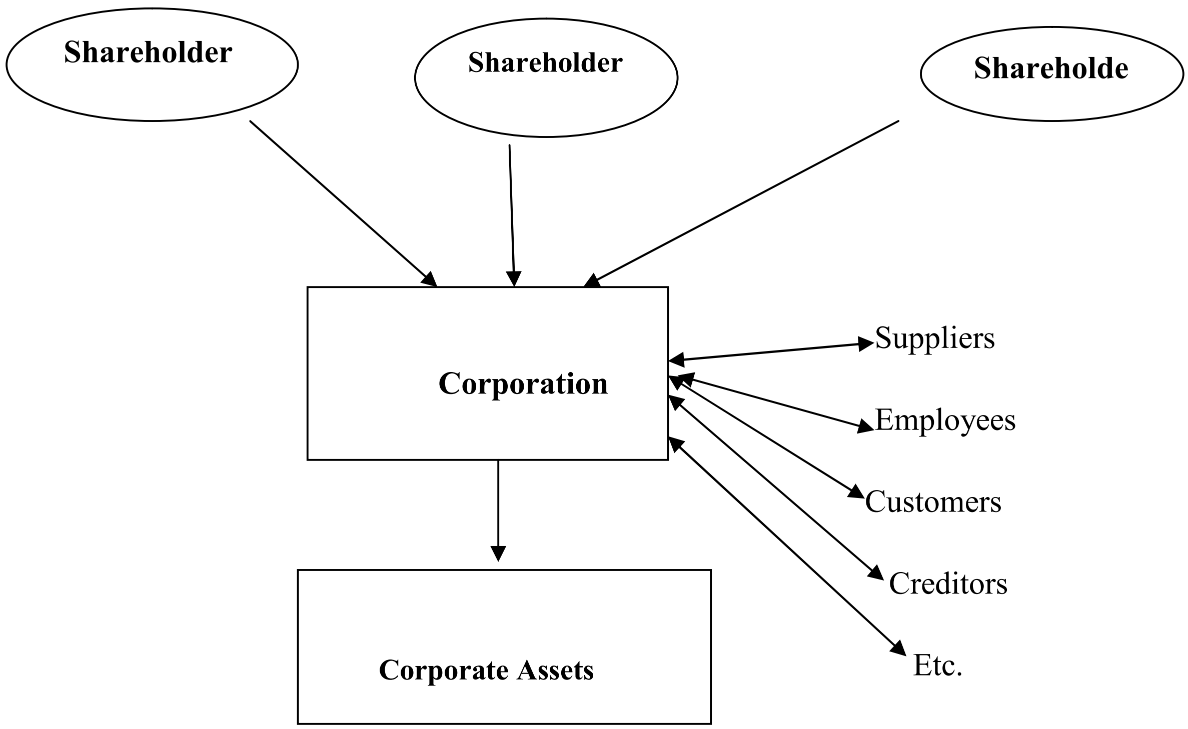

Fig. 1: A Two-Tier Ownership Structure of a Firm.

2.2 Meaning and Nature of Corporate Governance

The issue of governance touches many areas of human operations, including how economies and the entities within a country are managed, the political and juridical methods of governing a country, and how disputes are resolved in particular communities.[61] That is why it becomes difficult to find a single definition for the term "corporate governance" that can be applied to all situations and jurisdictions. Writers, regulatory bodies and other organizations define it from their own perspectives.

Outside sources have provided some definitions of corporate governance though they have difference in the way they define it. The simplest and most concise definition of corporate governance was provided by The Cadbury Committee Report of 1992. The Report defines it as:

[60] Iwai, *Supra note 54,* p.10

[61]An Overview of Corporate Governance and Accountability in Southern Africa , (The United Nations Economic Commission for Africa, Southern Africa Office, 2007), p.5

"Corporate governance is the system by which companies are directed and controlled".[62] Too simple and general, this definition fails to show the function of corporate governance and groups/persons involved in the process. There are also others who provide a similarly simple and general definition of corporate governance. Accordingly, corporate governance can be defined as procedures and processes through which an organization is directed and controlled.[63] Here also, the function of corporate governance and the participants in it are missing.

The Organization for Economic Cooperation and Development (OECD) provides a comparatively detailed meaning of corporate governance. It has the following to say on the nature of corporate governance:

> *"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."*[64]

Corporate governance can also be defined as consisting of *"…..the legal, contractual, and implicit frameworks that define the exercise of power within a company, that influence decision making, that allow the stakeholders to assume their responsibilities, and that ensure that their rights and privileges are respected."*[65]. This definition of corporate governance encompasses all the activities related with exercising power, sharing rights and responsibilities, and organizing the various functions of a company.

Other authors consider corporate governance as simply the prevention of theft from those who are in charge of running the corporation.[66] Related with this, Shleifer and Vishny state that

[62]The Cadbury Committee Report, *Supra note 12*, p.15

[63] Kolis Karel and Kubicek Ales, "Role of Customers in Stakeholders' Approach in Company Corporate Governance", World Academy of Science, Engineering and Technology, Vol.6, (2012), p.12

[64] OECD Principles of Corporate Governance, *Supra note 13*, p. 11

[65] Jean-Paul Page, Corporate Governance and Value Creation, The Research Foundation of CFA Institute Publication, (2005), p. 1 and 2

[66] S., Nganga, V., Jain and M., Artivor, Corporate Governance in Africa: A Survey of Publicly Listed Companies, (London Business School, 2003), as cited in *Supra note 61*, p.5

corporate governance deals with the ways suppliers of finance to corporations assure themselves of getting a return on their investment, how they make sure that managers do not steal capital or invest in bad projects which in general means "the mechanism through which outside investors are protected against expropriation by insiders".[67]

The available definitions of corporate governance may center on the company itself (an internal perspective) or an external aspect of the company. Most of the definitions that center on the company itself share the following summarized elements in common: (1) Corporate governance is a system of relationships, defined by structures and processes (2) These relationships may involve parties with different and sometimes contrasting interests (3) All parties are involved in the direction and control of the company and (4) All this is done to properly distribute rights and responsibilities and thus increase long-term shareholder value.[68] On the other hand, the external aspect of corporate governance, centers on relationships between the company and its stakeholders.[69]

It should be made clear from the various definitions that corporate governance is not only about the maximization of shareholder wealth, but an effort to balance shareholder interests with those of other stakeholders, such as managers, employees, customers, suppliers of corporations' inputs and investors, in order to achieve long-term sustainable value and contributing to the economic development of the countries in which the corporations operate.[70] This is also what is reflected by the definition rendered by the Organization for Economic Cooperation and Development (OECD).

The Ethiopian company law doesn't provide a definition of corporate governance. There is however a meaning given to it under special directives. Accordingly, Licensing and Supervision of Banking Business Bank Corporate Governance Directive No. SBB/62/2015 Article 2(2.3) defines it as:

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[67] Shleifer, A., and Vishny, R. W., A Survey of Corporate Governance, (NBER Working Paper Number W5554, 1996), as cited in *Supra note 61*, p.5

[68] The International Finance Corporation Corporate Governance Manual, *Supra note 14*, p. 6-8

[69] The International Finance Corporation Corporate Governance Manual, *Supra note 14*, p. 8

[70] *Supra Note 61*, p.6

"……the process and structure used to direct and manage the business and affairs of a bank towards enhancing business prosperity and corporate accountability with ultimate objectives of realizing long term shareholders' value as well as customers' and other stakeholders' interest"[71]

This definition considers corporate governance as a system for the direction and management of a bank by also putting the ultimate objective that needs to be achieved. The importance of considering the interests of stakeholders is also acknowledged in the definition.

Finally, it should be noted that corporate governance is different from corporate management. One writer noted in this regard:

"Corporate governance is not just corporate management; it is something much broader to include a fair, efficient, and transparent administration to meet certain well defined objectives. It is structuring, operating and controlling a company with a view to achieving long term strategic goals to satisfy shareholders, creditors, employees, customers and suppliers and to comply with the legal and regulatory requirements, apart from meeting environmental and local community needs."[72]

So, the governing body of a corporation doesn't deal with the daily operation of the organization. Such task falls under the activities of the management. The governing body has the role and responsibility of setting up the organization's strategic direction and overseeing, monitoring and controlling the management in the given direction.[73]

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[71] Licensing and Supervision of Banking Business Bank Corporate Governance, 2015, National Bank Directives No. SBB/62/2015, Article 2(2.3)

[72] Fernando A., "Corporate Governance –The Time for a Metamorphosis", The Hindu, (1997), as cited in *Supra note 3*, p.48

[73] Karel and Ales, *Supra note 63*, p.121

2.3 Why is Corporate Governance a Hot Topic?

A sizeable literature has been developed in the advanced economies on corporate governance though we don't find many studies on the topic in developing countries.[74] We also find some articles and research papers in Ethiopia which discuss corporate governance from various perspectives. But a question that may be asked is: why is corporate governance even a topic that is being given this much attention? Its answer may lie in two points.

One reason frequently stated is that it has instrumental value to achieve some purpose in the business. Some previous empirical studies have shown that there exists a positive correlation between corporate governance on the one hand and firm performance on the other.[75] Good corporate governance improves economic efficiency and growth as well as enhances investor confidence.[76] So, good corporate governance is believed to have a positive effect on firm value and investors' willingness on the company.

It has been found out that the existence of massive wrong doings and corporate governance failures have raised the need for corporate governance reform in recent times.[77] During the last decades, history has shown that a lot of bankruptcies are caused by violation of the corporate governance principles.[78] It has been more perceivable than ever in recent years that big corporations play an important role in the global economy which is expressed in the impact caused by the collapse of these big financial and non-financial corporations.[79] Corporate governance is also believed to have caused financial crisis when the system fails to make bank managers accountable to the shareholders.[80] All these instances necessitate corporate governance reforms.

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[74] Ashenafi Beyene, Kelifa Srmolo, Yodit Kassa, "Corporate Governance and Impact on Bank Performance", Journal of Finance and Accounting, Vol. 1, No. 1, (2013), p. 19. It can be found online at: http:// www.sciencepublishinggroup.com/j/jfa.

[75] Babatunde, A & Olaniran, O , "The Effects of Internal and External Mechanism on Governance and Performance of Corporate Firms in Nigeria", Journal of Corporate Ownership & Control, Vol. 7, No. 2, (2009), cited in Ashenafi Beyene et al, *Supra note 74*, p.19

[76] OECD Principles of Corporate Governance, *Supra note 13*

[77] Shao, *Supra note 1*

[78] Georgiana LUCACHE, Corporate Governance of Banks: A closer look at the Boards of Directors, (2012/2013, Unpublished, Tilburg University Law School), p.11

[79] *Ibid,* p. 4

[80] LUCACHE, *Supra note 78*, p. 4

The other argument could be the existence of separation of ownership and control in publicly held share companies. The separation of ownership and control in publicly held companies makes corporate governance essential as it raises the so called "agency problem".[81] The shareholders of companies usually delegate the directors and managers to make decisions concerning the activities of the company on their behalf. This delegation is based on the assumption that the agents (directors and managers) will act in the best interest of the shareholders. But contrary to this assumption, the management may disregard the best interest of the shareholders and pursue its own interest at the expense of the shareholders. So, good corporate governance will help in minimizing this conflict of interest between the principal (shareholders) and the agents (the management).

2.4 Corporate Governance in Ethiopia

2.4.1 General Background

Corporate governance is new to Ethiopia.[82] The fact that the development of corporate governance cannot be separated from the development of corporations is not an exception to Ethiopia. The development of companies and company laws in Ethiopia is a recent phenomenon since the first codified company law was made in 1931.[83] Some writers on modern business in Ethiopia state that especially after the Second World War Indians, Italians and Levant wholesalers, distributors and retailers handling a large variety and volume of goods in the towns; and enterprising merchants and shopkeepers who formed the basis of the Ethiopian business sector after 1954 replaced the existing small scale Greek, Armenian and Ethiopians, stall keepers and itinerant peddlers.[84] During post war period of the restoration of the Imperial Government of Haile Selassie I, companies with substantial capital were created through a mix of government, public and private partnership where the state had significant command and influence on key government institutions.[85] The establishment of share companies (aksionmehaber) became

[81] Ashenafi Beyene et al, *Supra note 74*, p.19
[82] Minga Negash, *Supra note 50*, p.4
[83] Assefa Aregay, *Supra note 53*, p. 8
[84] Minga Negash, "Corporate Governance and Ownership Structure: The Case of Ethiopia", Ethiopian E-Journal, Vol. 5, No. 2, (2013), p. 38
[85] Minga Negash, *Supra note 84*

routine between 1960 and 1973, and stock broking firms (trading firms) started to emerge.[86] The other positive development is the promulgation of the Civil and Commercial Codes in 1960.

The emerging growth of business organizations was brought to an end when the Imperial Regime was removed by a military coup in early 1970s and when all rural and urban lands, business enterprises and extra houses where nationalized for public use. Companies were nationalized and fell into the hands of the then government. The people who managed the nationalized corporations were appointees from the government or the military. Some even characterize the time following this period as a time where Ethiopia didn't have a corporation that passes the definitions found in the accepted conventional definition of company law.[87] However, this situation changed after the downfall of the Derg Regime and the subsequent establishment of privatization agency and the implementation of privatization program. Since 1995, about 276 state-owned enterprises and their branches have been sold to the private sector.[88] The privatization agency has transferred assets to (i) political party controlled regional (endowment) companies; (ii) Midrock Ethiopia, a privately held diversified conglomerate; (iii) few individuals and groups well connected to the regime.[89] Despite those privatizations, there was no key development in corporate law which in one way is characterized by the unchanged Commercial Code of 1960.[90]

Unlike majority of companies in the past which were formed among founders, there are a number of share companies that are being formed currently by the sale of shares to the public.[91] There are also some writers who argue that the separation between ownership and control in publicly held share companies is growing in Ethiopia, and submit some empirical evidence in support of this claim.[92] This creates what is widely recognized as "agency problem" and requires a strong corporate governance mechanism. But contrary to this, the corporate governance status in Ethiopia is not adequate for the current needs. That is why some people assert that the status

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[86] MingaNegash, *Supra note 50*, p.5

[87]Minga Negash, *Supra note 84*

[88] GetahunSeifu, "Revisiting Company Law with the advent of the Ethiopian Commodity Exchange (ECX): An Overview, <u>Mizan Law Review</u>", Volume 4(1), (2010), P.103-140, cited in Minga Negash, *Supra note 77*, p. 39

[89] Minga Negash, *Supra note 50*, p.6

[90] Minga Negash, *Supra note 84*, p. 39

[91] Hussein Ahmed, *Supra note 30*, p. 49, citing *Addis Fortune*, *Supra note 52*

[92] *See* Fekadu Petros, *Supra note 48*

of corporate governance in Ethiopia is not adequate and can even be described as disappointing.[93]

2.4.2 The Legal Regime and Current Developments Relating to Corporate Governance

The issue of corporate governance is a recent phenomenon in developing countries like Ethiopia. Unlike in other countries, we don't find a codified rule on corporate governance in Ethiopia. Corporate governance of companies limited by shares in Ethiopia is mainly governed by The Com. Code of 1960. It is the main source to be cited with respect to the governance of corporations. In addition to this, there are other laws and rules which directly and indirectly deal with corporate governance issues.

The Com. Code articles from 347 to 428 contain provisions that regulate the governance of companies. These articles deal with (1) the rights of shareholders, (2) the powers, duties and liabilities of directors and auditors and (3) the manner as to how decisions are made in companies. In this regard, the heading of Book II, Title VI, Chapter 4 of the Com. Code is presented as "Directors, Auditors and Shareholders' meetings." It is however recommended now that the heading should be put as "Corporate Governance".[94]

In addition to the Commercial Code, there are other sector-specific proclamations and directives which contain some rules on corporate governance issues.[95] These are: Banking Business Proclamations No. 592/2008, Microfinance Institutions Proclamation No. 626/2009, Insurance Business Proclamation No. 746/2012, The Commercial Registration and Business Licensing Proclamation No. 686/2010, Limits on Board Remuneration and Number of Employees Who Sit on Board of an Insurer National Bank Directive No. SIB/37/2014, Licensing and Supervision of Banking Business; Approval of Appointment of Independent Auditor National Bank Directive No. SBB/19/96, Licensing and Supervision of Banking Business; Limits on Board Remuneration and Number of Employees who Sit on a Bank Board Directive No. SBB/49/2011 and Licensing

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[93] Minga Negash, *Supra note 50*

[94] Belaynew Ashagrie, Corporate Governance in Branches of Foreign Companies in Ethiopia, (2014, Unpublished, AAU), p.44. *See* also Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA), Recommendations and Position Paper of the Business Community on the Revision of the Commercial Code of Ethiopia, (2008), p. 23

[95] *Ibid*, p.45, 46 and 47

and Supervision of Banking Business Bank Corporate Governance Directive No. SBB/62/2015 are some of the laws which contain relevant provisions on corporate governance.

Despite the abovementioned instruments which in one way or another cover corporate governance matters, the status of corporate governance in Ethiopia taken as a whole is described by some as problematic and inadequate. One writer has identified the problems as follows:

> *"………….. the legal instruments do not provide adequate back up; key international conventions and standards are not ratified; political parties own substantial number of business enterprises and operate in key sectors of the economy; ownership concentration through pyramid structure introduces particular problems of agency and creates crony capitalism; investor and creditor protection laws are inadequate; the absence of organized equity market is a serious void, and finally with regard to professional education, the increase in the number of tertiary institutions granting degrees and diplomas is not matched by sound quality standards."*[96]

Though the overall status of corporate governance in Ethiopia has the above problems, there are some developments that can be taken as a step towards improving corporate governance.

Firstly, the Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA) has adopted a voluntary Code of Corporate Governance for Ethiopia in 2011. The Code is one development that will have its own influence in improving the Ethiopian corporate governance. Secondly, there is an ongoing task to amend the 1960 Commercial Code of Ethiopia. This, among other things, is expected to include improvements on matters of corporate governance. The other development is the inauguration of the Ethiopian Institute of Corporate Governance (EICG) by the Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA) in

[96] Minga Negash, *Supra note 50*

2013.[97] Companies who join the institute as members will be obliged to follow a Code of Ethics that ensures they are living up to their ethical and social responsibilities.[98]

2.4.3 Corporate Governance Structure

There are various persons and groups involved in the corporate governance process. They can be categorized as internal and external actors.[99] The internal actors include directors, company secretary, sub-board management and employee representatives (trade unions).[100] The external actors on the other hand include shareholders, stock-exchanges, auditors, regulators and governments.[101]

The Commercial Code of Ethiopia incorporates provisions pertinent to the governance of share companies. The Code provides three parties as far as the governance of share companies is concerned. These are board of directors, auditors and the shareholders' meetings.[102]

Board of Directors

Generally, the board is responsible for providing entrepreneurial leadership, either directly or through its committees. Unlike other countries' board (eg. Germany) Ethiopia does not recognize a two-level board structure but rather adopts a single-tier board structure.[103]

The Board of directors, which is the highest organ of management and one of the three organs of share companies recognized under the Ethiopian share company law, forms the primary organ of corporate governance.[104] The Ethiopian Commercial Code requires that there should be at least

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97 http://www.2merkato.com/news/alerts/2656-ethiopian-corporate-governance-institute-inagurated, accessed on July 12, 2015

98 Addis Fortune, Jan 27, 2013, Vol. 13, No. 665 available at http://addisfortune.net/articles/chamber-to-launch-corporate-governance-institute/, accessed on July 12, 2015

99 Corporate Governance - External and Internal Actors, The Association of Chartered Certified Accountants (ACCA) available at http://www.accaglobal.com/za/en/student/exam-support-resources/professional-exams-study-resources/p1/technical-articles/corporate-governance.html)

100 *Ibid*

101 *Ibid*

102 Commercial Code of the Empire of Ethiopia (hereinafter called Com. Code), 1960, Proc. No. 166, Negarit Gazeta, Year 19, No. 3, articles from 347 to 428

103 Assefa Aregay, *Supra note 53*, p. 24

104 Assefa Aregay, *Supra note 53*, p. 24

three and at most twelve directors who form the board of directors.[105] Persons in the board of directors should be members of the company and cannot be outsiders.[106] A chairman shall be elected by the board when this has not been done by a meeting of subscribers or shareholders.[107] The board shall also elect a general manager (sometimes called chief executive officer (CEO), who may not be a director and may also elect a secretary.[108] The general duties of directors are provided under Art.362 of the Com. Code. Accordingly, directors are responsible for (1) keeping regular records of the management and of meetings, (2) keeping accounts and books, (3) submitting the accounts to the auditors and an annual report of the company's operations including a financial statement to the meetings, (4) convening meetings as provided in the articles of association, (5) convening a general meeting without delay where three quarters of the capital are lost, (6) set up the reserve funds required by law or the articles of association, and (7) apply to the court where the company stops payments with a view either to a composition with creditors or the winding-up of the company.

The other related component in corporate governance worth mentioning is the management. Generally, the management has delegated authority from the Board for performing the day-to-day management functions of the business and implementing all projects and initiatives as approved by the Board and the Executive Committee. The general manager, who may not be from members of the board of directors, is appointed and removed by the board of directors.[109] Although a general manager is an employee and may not be a director, he can still be a shareholder outside the board or a non-shareholder outsider.[110] The Commercial Code talks about a general manager to be appointed by the board and Articles 34, 35, 109 (1) (f) and 121 (h) are cross referred to regulate general managers.[111]

[105] Com. Code, Art. 347 (2)
[106] *See* Art. 347 (1) of the Com. Code Which Provides as "Only Members of a Company May Manage the Company"
[107] Com. Code Art. 348 (1)
[108] Com. Code Art. 348 (3)(4)(5)
[109] Com. Code Art. 348
[110] Legally speaking, this appears to be the Case from the reading of Art. 348 (4) of the Commercial Code as the prohibition is only being a general Manager and a board member.
[111] Com. Code. Art. 348 (3)

Shareholders

The other organ in the Ethiopian corporate governance is shareholders' meetings. Shareholders elect their representative directors at general meetings to oversee their company's affairs and business. The Commercial Code articles from 388 to 428 regulate the rights and powers of shareholders, the way these rights and powers are exercised and the different class of shareholders' meetings. The shareholder's meetings have powers on the directors, auditors and the company. It can be described that the shareholders' meetings are the means through which shareholders exercise and demonstrate their ownership right over the company.[112]

In their meeting, the shareholders may appoint or remove directors and auditors, decide the amount of their remuneration, amend the accounts after considering the report required under Art. 375 of the Com. Code, approve the issue of debentures as well as the guarantees attached thereto and decide all matters other than those reserved for extraordinary general meeting.[113] Articles 406 and 417 of the Com. Code also provide that every shareholder has the right to inspect and take copies of: balance sheets and profit and loss accounts; reports submitted by the directors and by the auditors to general meetings; minutes and attendance sheets of these meetings.

Auditors

Auditors are another component in the corporate governance structure of Ethiopia. They provide assurance on financial reporting and/or internal controls to ensure accountability and audit quality. An auditor performs two main functions: (1) guarantees the accuracy of reports presented by the management and (2) assesses and reports the overall economic condition of the corporation.[114] The Commercial Code from Articles 368 to 387 deals with the powers, duties, liabilities, appointment, removal and remuneration of auditors. Auditors have to be appointed by the shareholders' general meeting and are accountable to the same.[115] The duties of auditors are provided in the Com. Code as: (1) to audit the books and securities of the company, (2) to verify the correctness and accuracy of the inventories, balance sheets and profit and loss accounts, (3)

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[112] Belaynew Ashagrie, *Supra note 94*, p. 54 and 55
[113] Com. Code, Art. 419(2)
[114] Assefa Aregay, *Supra note 53*, p. 45
[115] Com. Code, Art. 368 & 369

to certify that the report of the board of directors reflects the correct state of the company's affairs, (4) to carry out such special duties as may be assigned to them, (5) to report the commission of an offence to a prosecutor and inform directors about irregularities or breaches of legal or statutory requirements, and other duties imposed on them.[116]

Auditors have the power to make checks and audits at any time on the spot as they think necessary and may call for any information and documents of the company.[117] They may also face civil and criminal liabilities when they exhibit any failure with regard to their duties.[118]

The above are components of Ethiopian corporate governance structure. In addition to this, there are other stakeholders who interact in daily operations with the company and in some way affect or be affected by the corporate governance or the performance of the company. These can be employees, customers, suppliers, institutional investors, market regulators, government bodies, market intermediaries.

[116] Com. Code, Art. 374 & 376
[117] Com. Code, Art. 378
[118] Com. Code, Art. 380 (1)(2)

CHAPETER THREE

3. Corporate Governance Models

This chapter is about theories and models of corporate governance. The debate about corporate governance models is typically traced back to the early 1930s.[119] Currently, there are many theories of corporate governance. Some of them are: agency, stakeholders and resource dependency theory, stewardship theory, social contract theory, legitimacy theory and political theory.[120] Among these, this chapter discusses three of them namely: agency theory, stewardship theory and stakeholder theory. The chapter also discusses the meaning and characteristics of the two competing models of corporate governance.

3.1 Theories of Corporate Governance in General

3.1.1 Agency Theory

Agency theory argues that the owners in the corporation are principals and the managers are agents who work for the principal.[121] This theory can be defined as "the relationship between the principals, such as shareholders and agents such as the company executives and managers".[122] In this theory, shareholders who are the owners or principals of the company, delegate the running of business to the directors or managers, who are the shareholder's agents.[123] It considers the agency relationship in the company as a contractual link between those shareholders that provide capital to the company as principals and the management as an agent who runs the company.[124]

[119] Jhon Roberts, The Theories Behind Corporate Governance, The Judge Business School, available at http://www.havingtheircake.com/content/1_Ideas%20that%20shape%20the%20world/fact%20and%20opinion/The%20theories%20behind%20corporate%20governance.lnk#header , accessed on Saturday, 13, June 2015 at 04:06 pm

[120] Wan Fuaziah Wan Yusoff and Idris Adamu Ahaji, "Insight of Corporate Governance Theories", Journal of Business Management, Science and Education Center of North America, Vol.1.Issue, (2012), p.53

[121] Lex Donaldson and James H. Davis, "Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns", Australian Journal of Management, 16, I, (1991), p. 50

[122] Haslinda Abdullah and Benedict Valentine, "Fundamental and Ethics Theories of Corporate Governance", Middle Eastern Finance and Economics, Issue 4, (2009), p.89

[123] *Ibid*

[124] Government-Linked Companies Research Center, available at http://ari-glcrc.blogspot.com

The principals engage the agent to perform some services on their behalf and would normally delegate some decision-making authority to them.[125]

As the distant shareholders employ professional executives to act on their behalf, there is a fundamental problem that the agent is likely to be self-interested and opportunistic.[126] The shareholders in this theory expect the agents to act and make decisions in the principal's interest.[127] On the contrary, the agents may not necessarily make decisions in the interests of the principals.[128] The agent may be succumbed to self-interest, opportunistic behavior and falling short of congruence between the aspirations of the principal and the agent's pursuits.[129] The model of an employee represented in the agency theory is more of a self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority.[130] Executives may serve their own interest and disregard those of their principals. In relation to this, Adam Smith has once explained: "You cannot expect those who manage other people's money to be as careful and caring as it would belong to them. Waste and negligence are present, always, more or less, in the management of every business."[131]

To avoid such problem, according to this theory, the principal incurs 'agency costs' that come from the necessity of providing incentives to executives and monitoring the conduct of the same.[132] Such agency cost is to the extent to which returns to the residual claimants, the owners, fall below what they would be if the principals, the owners, exercised direct control of the corporation.[133] A mechanism is specified for such agency cost by the agency theory which,

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[125] *Ibid*

[126] Roberts, *Supra note 119*

[127] Abdullah and Valentine, *Supra note 122*, p.89

[128] *Ibid*

[129] *Ibid*

[130] *Ibid*, p.90

[131] Sorin Nicolae BORLEA and Monica-Violeta ACHIM, "Theories of Corporate Governance", Studia Universitatis "Vasile Goldiş" Arad, Economics Series, Vol 23, Issue 1, (2013), p. 118

[132] Roberts, *Supra note 119*

[133] Jensen, M.C. and W.H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", Journal of Financial Economics, 3, (1976) P. 305–360 as cited in Donaldson and Davis, *Supra note 121*, p.50

among others, includes incentive schemes for managers that goes in line with maximizing shareholders' interests.[134]

3.1.2 Stewardship Theory

Stewardship theory assumes that managers are stewards whose behaviors are aligned with the objectives of their principals.[135] Managers, according to this theory, are viewed as loyal to the company and interested in achieving high performance. The steward's behavior in this theory is pro-organizational and collectivist and will not depart from the interest of the organization as the steward seeks to meet the objectives of the organization.[136] This theory assumes that managers are faithful, responsive and effective and therefore, they are good administrators of the resources entrusted.[137] The conceptual foundation of the theory is related to some motivation theories which assume that managers are rational beings, so there isn't any need to excessively monitor their behavior as the agency theory assumes.[138]

Unlike agency theory, stewardship theory stresses not on the perspective of individualism, but rather on the role of top management being as stewards, integrating their goals as part of the organization.[139] The stewardship perspective proposes that stewards are satisfied and motivated when organizational success is achieved.[140] In relation to this, it has been described as *"a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized".*[141]

This theory rejects the agency theory's assumption that executives are self- interested but rather proposes pro-organizational motives of directors.[142] It criticizes the agency theory's assumption that shareholders and executives have contradictory motives and argues that the two have aligned

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[134] Eisenhardt, K.M., "Agency Theory: An Assessment and Review", Academy of Management Review, 14, 1, (1989), 57–74, as cited in Donaldson and Davis, *Supra note 121*, p.50
[135] *Supra note 124*
[136] *Supra note 124*
[137] *Supra note 131*, p. 120
[138] *Supra note 131*, p. 120
[139] Abdullah and Valentine, *Supra note 122*, p.90
[140] Abdullah and Valentine, *Supra note 122*, p.90
[141] Abdullah and Valentine, *Supra note 122*, p.90
[142] Roberts*, Supra note 119*

interest in maximizing the long term stewardship of the company.[143] According to this theory, it is the personal identification with the aims and purposes of the organization that drives performance and not the aligned greed of an executive.[144]

3.1.3 Stakeholder Theory

The idea of stakeholder theory began back in the 1960s but a discussion about its influence began in 1984 by Freeman.[145] Stakeholder theory can be defined as *"any group or individual who can affect or is affected by the achievement of the organization's objectives".*[146] This theory, which clearly rejects the view that shareholders have a privileged place in the business enterprise, argues that corporations should serve all groups or individuals who have a stake in the corporation and mainly includes employees, customers, suppliers, and local communities.[147] This theory argues that a company should be managed in the interests of all its stakeholders and not only shareholders.[148]

Stakeholder theorists suggest that managers in organizations have a network of relationships to serve which include the suppliers, employees and business partners unlike agency theory in which the managers are working and serving for the stakeholders.[149] So, the stakeholder theorists argue that corporations should take into account the interests of all stakeholders not only shareholders. This theory will be dealt in detail in the next sections.

3.2 Shareholder Model of Corporate Governance

3.2.1 In General

We find many different models of corporate governance around the world. Every country has corporate governance system with different peculiarities because of the strong influence that the rules, the institutions and the social regulation, have on the characteristics and function of the

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143 Roberts*, Supra note 119*
144 Roberts, *Supra note 119*
145 Karel and Ales, *Supra note 63*, p.121
146 Abdullah and Valentine, *Supra note 122*, p.91
147 Shao, *Supra note 1*, p. 6 and 7
148 Roberts*, Supra note 119*
149 Abdullah and Valentine, *Supra note 122*, p.91

company's management mechanisms.[150] Literature agrees that corporate governance models in the world can be divided into two: the Anglo-Saxon and the European (or German-Japanese).[151] Most countries in the world adopt one of these two models, each of which differs depending on the specific conditions in which the state itself operates.[152] Before moving to the details of both models of corporate governance, a general introduction as to the characteristics of the models and the countries which follow each model will be discussed in the next and subsequent section.

The Anglo-American model (also called the Shareholder Model) is well known in countries like the United States, United Kingdom, Canada, Australia and New Zealand. Countries that follow the Anglo-American Model adopt an "outsider system" due to the model's main focus on outside investors. The conflict between the stakeholder and the management is ruled by the financial market.[153] The capital market can regulate the management and develop the creation of value for shareholders.[154] Its reliance on the capital market as the place of control over the corporation is the main feature of this model.[155]

According to the shareholder model, the objective of a firm is to maximize shareholder wealth through allocative, productive and dynamic efficiency.[156] This model puts a strong emphasis on the results achieved by the company and security of their shareholders whereas long-term business development is given less importance.[157] The market value (i.e. shareholder value) of the firm is the criteria by which performance is judged in this model.[158] The principal-agent relationship arising from the separation of beneficial ownership and executive decision-making is the condition from which the underlying problem of corporate governance in this model

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[150] A. Zattoni, Corporate Governance, A. Zattoni Ed, (Milan, Egea, 2006), p. 202.
[151] A. Zattoni, "The Structure of Corporate Groups: The Italian Case" ,Corporate Governance - An International Review, Vol. 7, (1999), p. 38-48
[152] Clarke Thomas and Douglas Branson, The SAGE Handbook of Corporate Governance, SAGE, (2012), p. 20-21
[153] Alessandro Merendino, "International Theories of Corporate Governance: Critical Analysis and Evidence of the Italian Model", Journal of Economics, Business and Management, Vol. 1, No. 1, (2013), p.142
[154] A. Singh, Corporate Take-overs, , in J. Eatwell, M. Milgate, and P. Newman (ed), The New Palgrave Dictionary of Money and Finance, (London: Macmillan, 1992), p. 480-486
[155] Encyclopedia of Management, available at: http://mfiles.pl/en
[156] Maria Maher and Thomas Andersson, Corporate Governance: Effects on firm Performance and Economic Growth, (Organization for Economic Co-operation and Development, 1999), p. 6
[157] Encyclopedia of Management, *Supra note 155*
[158] Maher and Andersson *, Supra note 156*, p. 6

stems.[159] This is because when there is separation of ownership and control, the objectives of managers deviate from the profit maximization goal of the shareholders.

Anglo-Saxon countries follow the one-tier system or monistic model for their corporate governance in that there is only one appointment level (appointment of directors) by the shareholders' assembly.[160] This model is also characterized by the dominance of independent persons and individual shareholders in the company.[161] The shareholders are especially interested in profitable activities and received dividends and the manager is responsible to them and the Board of Directors.[162] This model feels a lack of strategic development but ensures the mobility of investments and their placement from the inefficient to the developed areas.[163] Managers and shareholders have a short-lived and official relationship.[164]

In general, the Anglo-American model is characterized by the following features:[165]

- Management dominated and shareholder focused
- Wide public share ownership
- Strong shareholder rights
- Unitary board structure
- Single powerful leader
- Shareholder litigation culture
- Banks only slightly engage in the operations of the company
- Market is an active mechanism of control over the corporation and
- Measure of success is the share price and dividend.

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[159] Maher and Andersson *, Supra note 156*, p. 6
[160] Merendino, *Supra note 153*, p. 142
[161] Mihaela Ungureanu, Models and Practices of Corporate Governance Worldwide, (AlexandruIoan Cuza University of Iasi, România, CES Working Papers), p.626 available at: http://www.ceswp.uaic.ro/articles/CESWP2012_IV3a_UNG.pdf
[162] *Ibid*
[163] *Ibid*
[164] Encyclopedia of Management, *Supra note 155*
[165] W. Salacuse, Corporate Governance in the UNECE Region, (Paper commissioned for the Economic Survey of Europe, the Secretariat of the United Nations Economic Commission for Europe, UN/ECE, Geneva, 2002), p. 51. *See* also Encyclopedia of Management, *Supra note 155*

3.2.2 Shareholder Model Explained

With roots in Adam Smith's (1776) The Wealth of Nations, the origins of the ideas shaping shareholder theory are more than 200 years old.[166] Shareholder perspective of corporate governance has its roots in the principle of private property rights which is the foundation of capitalism.[167] The shareholder (also called "Anglo-American", "common law", "outsider" or market-oriented model) was originally proposed by Milton Friedman. Friedman argues in favor of maximizing financial return for shareholders and says that "*there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud. ...*".[168] Friedman believes that while individual persons may have social responsibilities, companies are artificial persons that do not have these responsibilities.[169] The shareholder view, it could be said, is premised on the idea of a market economy, the definition of which is an economic system combining the private ownership of productive enterprises with competition between them in the pursuit of profit.[170] Such a formulation has an advantage in that it picks out the three aspects which are generally accepted as defining features of the market system: private ownership, competition and profit motive.[171]

The three assumptions that provide support to the shareholder view of a firm are reflected in Friedman's statements. The first one is that human, social, and environmental costs of doing business should be internalized only to the extent required by law and the rest should be externalized.[172] Secondly, it is assumed that self-interest is the prime human motivator that makes people and organizations act in their own interest to maximize efficiency and value for

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[166] Michael D. Pfarrer, What is the Purpose of the Firm? Shareholder and Stakeholder Theories, Good Business: Exercising Effective and Ethical Leadership, New York, (2010), p. 86
[167] Shao, *Supra note 1*, p. 6
[168] Saint and Tripathi, *Supra note 37*, p.2 (emphasis added)
[169] The Debate over the Shareholder Model of Corporate Governance: Is the shareholder model the best strategy of corporate governance in managing a public company?, (Daniels Fund Ethics Initiative, University of New Mexico), http://danielsethics.mgt.unm.edu
[170] Tony Ike Nwanji and Kerry E. Howell, "The Stakeholder Theory in the Modern Global Business Environment", International Journal of Applied Institutional Governance, Vol. 1, Issue 1, p.2 available at: www.managementjournals.com
[171] *Ibid*
[172] Saint and Tripathi, *Supra note 37,* p.2

society.[173] The third assumption is that the firm is basically a nexus of contracts with primacy going to those contracts that have the greatest impact on the profitability of the firm.[174]

The shareholder model is an Anglo-American model of corporate governance which governs corporations in the UK, the US, Australia, Canada, New Zealand and several other countries. It asserts that the corporation belongs to stockholders and their interest must be run.[175] Adam Smith's notion of the invisible hand of the market that he laid out in his seminal book, The Wealth of Nations, is the underlying concept behind this view of corporate governance in a sense that if firms maximize the wealth of their shareholders and individuals pursue their own interests then the allocation of resources is efficient.[176] Shareholder theorists call for limited government intervention in business, and believe that markets are best regulated through the invisible hand mechanism—that is, if all firms work in their own self-interest by attempting to maximize profits, society at large will benefit.[177] Some supporters of the shareholder view even believe that the invisible hand checks illegal activity, arguing that the market will penalize or discard, firms that engage in illegal or unethical behavior.[178]

In view of this model, the role of a firm in society is precisely to create wealth for shareholders.[179] Maximization of shareholders value is the main objective of US corporations where as companies in Germany consider balancing the interests of a wide range of different stakeholders as their primary goal.[180] One of the leading proponents of this approach, Berle, argued that boards and managers should direct the company for the sole interests of maximizing shareholders' profit by disregarding the interests of other stakeholders.[181] In this model, the corporation as a legal extension of its shareholders should be obliged to serve the interests of its

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[173] Saint and Tripathi, *Supra note 37*, p.2
[174] Saint and Tripathi, *Supra note 37*, P.2
[175] Alberto Chilosi and Mirella Damiani, Stakeholders vs. Shareholders in Corporate Governance, (University of Pisa and University of Prugia, 2007), p. 2 & 5 available at: http://mpra.ub.uni-muenchen.de/2334/
[176] Franklin Allen and Mengxin Zhao, The Corporate Governance Model of Japan: Shareholders are not Rulers, (2007), p.1
[177] Pfarrer , *Supra note 166*, p.87
[178] Pfarrer, *Supra note 166*, p.87
[179] Allen and Zhao, *Supra note 176,* p. 2
[180] Hoffmann, *Supra note 36*
[181] Adolf A. Berle, "Corporate Powers as Powers in Trust", Harvard Law Review, 44 (7), (1931), p. 1049, as cited in Gebeyaw Simachew, A Critical Analysis of the Ethiopian Commercial Code in Light of OECD Principles of Corporate Governance Framework, (2012, Unpublished, University of London), p.31

shareholders who own it.[182] This model is based on the premise that owners risk their investment capital and are the sole residual claimants, while other parties (say employees) are compensated on the basis of their marginal products (paid wages based on competitive labor markets).[183]

This theory of corporate governance asserts that the social responsibility of a business is to increase business and shareholder's value.[184] It argues that since directors and executives of a company act as agents of the shareholders, they should use corporation's resources only for their principal's benefit.[185] The Shareholder model sees those actions to promote "community interests" as a way for managers to promote their own strength and prestige, and to expropriate shareholders of their resources.[186]

The fact that shareholders are morally and legally entitled to direct the corporation since their ownership investment is an extension of their natural right to own private property is the assumption on which the shareholder model of corporate governance relies.[187] This model sees companies as another form of personal property ownership. Supporters of this theory argue that the only responsibility of corporation is to make profits for its shareholders, and that the desire for corporate social responsibility can undermine the foundations of a free society with a free-market and private-property system.[188]

And finally, shareholder perspective of corporate governance can be categorized in to three models: the principal-agent or finance model, the myopic market model and the stewardship model.[189] The Principal-agent model is the most dominant theoretical model of corporate

[182] Gebeyaw Simachew, *Supra note 43*, p.7
[183] Sylvia Ayuso and Antonio Argandona, Responsible Corporate Governance: Towards a Stakeholder Board of Directors, (University of Navarra, IESE Business School, 2007), p. 2
[184] Friedman, M., Capitalism and Freedom, University of Chicago Press, (1962) as cited in Carrillo, *Supra note 34*, p. 97
[185] Carrillo, *Supra note 34*, p. 98
[186] Carrillo, *Supra note 34*, p. 98
[187] Steven M. Mintz, Improving Corporate Governance Systems: A stakeholder Theory Approach, (Claremont McKenna college), p. 21
[188] Shao, *Supra note 1*, p. 6
[189] Mark Boadu, "Literature Review on Corporate Governance Models", International Journal of ICT and Management, Vol. II Issue 2, (2014), p. 137

governance.[190] It states that the maximization of shareholders' prosperity is viewed as a social function of a corporation.[191] This model asserts that making profits is the only role of a company and that other social function should be undertaken by the government.[192] The Myopic Market Model is similar to the agency theory and the finance model that the firm's purpose is to maximize the shareholders' wealth. [193]This model criticizes the Anglo-American corporate governance system as being fundamentally flawed by an excessive concern for short-term gains due to huge market pressures.[194] Supporters of this model suggest that firms should focus on long term investments and call for increased shareholder loyalty and interests.[195] The stewardship model rejects self-interest and seeks other ends such as: a sense of worth, a good reputation, a job well done, a feeling of satisfaction and a sense of purpose which are beyond financial interest.[196] This model argues that managers are stewards who serve the shareholders' interests and diligently work to attain a maximum corporate profit and shareholder returns.[197]

3.3 Stakeholder Model of Corporate Governance

3.3.1 In General

The other corporate governance model is called the German-Japanese or stakeholder model. This model adopts the insider-system and is also known also as "relationship based" as it is a network-oriented corporate system.[198] Countries that adopt the German-Japanese model have the "two-tier" or "dualistic" model for their corporate governance.[199] This model uses a bank-oriented perspective and the presence of the financial market is insufficient.[200] The main

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[190] S. Letza, X. Sun, and J. Kirkbride, "Shareholding versus Stake holding: A Critical Review of Corporate Governance", Corporate Governance: An International Review, 12 (3), (2004), p. 242-268
[191] Steve Letza et al , "Corporate Governance Theorizing: Limits, Critics And Alternatives", International Journal of Law and Management, Vol. 50, (2008), p. 18
[192] Milton Friedman, "The Social Responsibility of Business is to Increase its Profits", The New York Times, (1970)
[193] Boadu, *Supra note 189*, p. 138
[194] Steve LETZA, Xiuping SUN, "Corporate Governance: Paradigms, Dilemmas and beyond", The Poznań University of Economics Review, Vol. 2, No. 1, (2002), p. 43-63.
[195] Boadu, *Supra note 189*, p. 138
[196] Boadu, *Supra note 189*, p. 138
[197] Letza et al, *Supra note 190*, p. 242-268
[198] Merendino, *Supra note 153*, p. 142
[199] Merendino, *Supra note 153*, p. 142
[200] Merendino, *Supra note 153*, p. 142

assumption of this system is to rely on banks as a source of finance due to shallow and small financial markets for funding through shares and bonds.[201]

This perspective of corporate governance holds that corporations should be "socially responsible" institutions which are managed in the public interest.[202] Performance is judged, according to this model, not by maximization of shareholders value but by a wider constituency interested in employment, market share, and growth in trading relations with suppliers and purchasers, and financial performance.[203] This continental model puts much emphasis on the development of the company and its long-lasting effects.[204]

In this model, the firm's institutional asset is characterized by high degree of ownership concentration and banks, others family firms and the internationals investors (the so called block holders) are the main shareholders.[205] Shareholders participate in the management and control of the company and have common interests with the organization.[206] Unlike the Anglo-Saxon model, managers in this model are responsible to a wider group of stakeholders, in addition to shareholders, such as unions, business partners, etc.[207] There is an active involvement of institutional and individual owners and workers' unions (eg. Germany) through supervisory boards in the exercise of control on managers and the company.[208] Control in this model is mainly exercised by supervisory board of the company and other committees (the audit, remuneration, etc.) [209]

German-Japanese model is characterized by the following features:[210]

- Controlling shareholder dominated
- Concentrated share ownership
- Weaker shareholder rights

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[201] Encyclopedia of Management*, Supra note 155*

[202] Maher and Andersson, *Supra note 156*, p. 8 & 9

[203] Colin Mayer, Corporate Governance, Competition and Performance, (OECD Economic Studies, No. 27, 1996), p. 7-34

[204] Encyclopedia of Management*, Supra note 155*

[205] Merendino, *Supra note 153*, p. 142

[206] Ungureanu, *Supra note 161,* p.628

[207] Ungureanu, *Supra note 161*, p. 628

[208] Encyclopedia of Management*, Supra note 155*

[209] Encyclopedia of Management*, Supra note 155*

[210] Salacuse, *Supra note 165*, *See* also Encyclopedia of Management, *Supra note 155*

- Two-level board structure
- Weaker litigation culture.
- Substantial involvement of banks in financing and the operations of the company
- Long term development of the company (stakeholder focused)
- Satisfaction of involved interest groups is measure of success of the company

3.3.2 Stakeholder Model Explained

> *"Why should I care about the shareholders, who I see once a year at the general meeting? It is much more important that I care about the employees; I see them every day".*[211]

The above statement was made by the CEO of the German car maker Volkswagen noting the importance of stakeholder model of corporate governance. Stakeholder theory of corporate governance (also called "continental law", "German-Japanese", "insider" or "network-oriented" model) can be traced back to the work of R. Edward Freeman and his book Strategic Management: A Stakeholder Approach.[212] Freeman argued that firms must address the interests of their stakeholders - those who can affect or be affected by the firm's activities.[213] Freeman raised the theory as a counter argument to the theory that directors of a company are accountable to the shareholders.[214] Since the 1980s the stakeholder theory has developed the thesis that the organization has a moral relationship with groups other than shareholders.[215] This is founded on the assumption that organizations as well as individuals have moral status and therefore should act in a morally responsible manner.[216] One of the proponents of this approach, Dodd, contended

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[211] Goergen Marc, International Corporate Governance, (2012), p.5 as cited in Nurullah TEKİN, "The Notion of Corporate Governance and Comparison of the US, UK and German Corporate Governance Models", Law & Justice Review, Vol. V, Issue 1, (2014), p. 247 and 248

[212] Sylvia Ayuso, Miguel Angel, Roberto Garcia and Miguel Angel, Maximizing Stakeholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance, (University of Navarra, IESE Business School, 2007), p. 2

[213] Ayuso et al, *Supra note 212*, p. 2

[214] http://www.lawteacher.net

[215] Nwanji and Howell, *Supra note 170*

[216] Nwanji and Howell, *Supra note 170*

that boards should direct the company not only for the interests of shareholders but also for the interests of different stakeholders who make “firm specific investments” within the company.[217]

This model proposes expanding the focus of managers and the firm beyond the traditional interest groups of shareholders to understand and meet the needs and values of those interest groups previously perceived to be outsiders.[218] The stakeholder model asserts that a corporation must be run in the interest of stakeholders.[219] This model has acceptance even in the United States. Steve Jobs of Apple, for instance, emphasized the “customer first” approach which helped Apple focus on developing quality products that would “delight” customers, best meeting their needs for quality technological products.[220]

Stakeholder model of corporate governance is founded on the premise that stakeholders directly or indirectly contribute to the company’s achievement of its objectives and its wealth building capacity.[221] As stakeholders can affect or be affected by the activities of the company, their different interests should be taken into account by the management and board of directors.[222] This model of corporate governance may also include the corporate social responsibility of a firm considering the whole society as a stakeholder.[223] Two reasons can be forwarded for a company to pay attention to stakeholder groups. The first reason is that it can be considered that the demands of these groups have some intrinsic value, so that the company is responsible to meet their legitimate claims (which are a normative approach).[224] Secondly, taking into account

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[217] E. Merrick Dodd, “For Whom are Corporate Managers Trustee?”, Harvard Law Review, 45(7), (1932) P. 1145, 1149; Janis Sarrat, “Governance versus Divergence, Global Corporate Governance at the Crossroads: Governance Norms, Capital Markets & OECD Principles for Corporate Governance”, Ottawa Law Review, 33, (2002), p. 177, 196-20, as cited in Gebeyaw Simachew, *Supra note 181*, p.31
[218] Ayuso et al, *Supra note 212*, p. 2
[219] Chilosi and Damiani, *Supra note 175,* p. 2
[220] *Supra note 169*
[221] Stakeholder Engagement and the Board: Integrating Best Governance Practices, An International Financial Corporation Publication, (2009), p.12, available at http://www.ifc.org/wps/wcm/connect/19017b8048a7e667a667e76060ad5911/FINAL%2BFocus8_5.pdf?MOD=AJPERES
[222] *Ibid*
[223] Chilosi and Damiani, *Supra note 175,* p. 2
[224] Ayuso and Argandona, *Supra note 183*, p. 2

and responding to stakeholder's interests can improve company performance as they are perceived to have influence (which is instrumental approach).[225]

A framework, which fits three levels of stakeholder analysis– rational, process and transactional, has been suggested by Freeman.[226]Understanding as to who are the stakeholders of a corporation and the interests they have is necessary at the rational level.[227] The author also claims that at the process level, it is necessary to understand how the organization manages its relationships with its stakeholders and whether such fits with the rational stakeholder map of the organizations.[228] Lastly at the transactional level, the set of transactions or bargains among the corporation and its stakeholders must be understood and we must deduce whether these negotiations fit with the stakeholder map and the organizational processes for stakeholders.[229]

What is more, this theory can be presented and used in three broad types: (i) descriptive stakeholder theory which aims at describing specific corporate behaviors and characteristics, (ii) instrumental stakeholder theory which is concerned with, in conjunction with descriptive /empirical data where available, identifying the connections, or lack of connections, between stakeholder management and the achievement of traditional corporate objectives and (iii) normative stakeholder theory which assumes that regardless of the consequences to the firm, managers should consider stakeholder interests since they have an ethical obligation.[230] The descriptive stakeholder theory describes about how managers, firms, and stakeholders in fact interact.[231] The instrumental stakeholder theory assumes that managers should take into account

[225] Ayuso and Argandona, *Supra note 183*, p. 2

[226] R. Edward Freeman, "Strategic Management: A Stakeholder Theory", Journal of Management Studies, 39(1), (1984), p.1-21 cited in Nwanji and Howell, *Supra note 170*, p. 4

[227] *Ibid*

[228] *Ibid*

[229] *Ibid*

[230] Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications", The Academy of Management Review, Vol. 20, No. 1,(1995), P. 70-71 and Simone de Colle, "A Stakeholder Management Model for Ethical Decision Making", Int. J. Management and Decision Making, Vol. 6, Nos. 3/4, (2005) p. 303

[231] Donaldson T., and Preston, L. "The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications", Academy of Management Review, 20, (1), (1965) P. 65-91

the interest of stakeholders to maximize the objective function of their firms.[232] The third normative stakeholder theory prescribes what managers ought to do.[233]

3.3.3 "Stakeholders" and "Stakes"?

When we talk about stakeholder model of corporate governance, the issue that needs explanation is who are stakeholders in the first place? And what are their interests to be addressed?

The term "stakeholders" was recognized since the 1930's when identification of four major stakeholders namely: shareholders, employees, customers and general public were supported by a Harvard law professor, E. Merrick Dodd.[234] Stakeholders are those who have a stake in the company, and have the possibility of getting benefits or sustaining losses or harm as a consequence of operation of the company.[235]According to Freeman, a stakeholder can be taken to refer to any group or individual in an organization who can affect or is affected by the achievement of the organization's objectives.[236] Stakeholders are either potential beneficiaries or risk takers of the company's activities.

Stakeholders can be classified as primary ones/ economic stakeholders (those essential for the existence of the business and have some contract with it) and secondary ones (political and social stakeholders who help in getting credibility and acceptance).[237] Inside and outside stakeholders is also another classification of these groups. Some examples of stakeholder groups include: financial institutions (banks and shareholders), government (legislators and regulators) interest groups (NGOs and community) business (employees, customers, consumers and competitors).[238]

The stakeholders mentioned above have their own interests or 'stakes' in the corporation which they need to be considered. So the term "stake" has to be explained which can be defined in different ways. In terms of stakeholder theory a "stake" in an organization rests on "legal, moral, or presumed" claims or on the capacity to affect an organization's behavior, direction, process, or

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[232] *Ibid*
[233] *Ibid*
[234] *Supra note 221*
[235] *Supra note 221*
[236] Neil Jeffery, A Stakeholder Engagement: A Road Map to Meaningful Engagement, Doughty Centre, Cranfield School of Management, (2009), p.11
[237]Ayuso et al, *Supra note 212*, p. 6
[238] Practices and Principles for Successful Stakeholder Engagement, (2007), available at: www.sustainability.com

outcomes".[239] Reed also defines it as "stakes are understood to impose normative obligations….we will define a stake as 'an interest for which a valid normative claim can be advanced'."[240]

The following listing shows the various stakeholders and their stakes in the corporation:[241] Stockholders:- want to ensure that managers are behaving ethically and not risking investor's capital by engaging in actions that could hurt the company's reputation. They also want to maximize their return on investment. Managers: - have stakes similar with employees. They are responsible to increase the company's performance by using financial and human resources. Employees: - want companies to work ethically towards them by treating them fairly and equitably for their contributions in terms of payment, promotion and security. They also want a healthy and safe working environment. Suppliers: - provide goods and services and want to be paid fairly and promptly for their input. Distributors: - want quality products at agreed prices. Consumers: - as most critical stakeholders, buy corporate products and want honesty, quality goods with fair price. Local communities: -provide the firm with vital resource and require job opportunity, safe working environment, minimized pollution and negative externalities. Government: - provides the legal and institutional framework necessary and wants companies to abide by the law and pay taxes.

So, when we say stakeholder model of corporate governance, we are referring to a governance system that takes into account the interest of these groups.

3.3.4 Stakeholder Engagement/Stakeholder Power

Once we believe in the usefulness of stakeholders' governance, the question remains as to how they are going to engage in the decision making process. Should stakeholders make a mere engagement? Or should they be allowed to participate in the internal decision making process and have impact on the company's activities? This question is not yet settled. Engagement is the practice of exchanging information, learning from and listening to stakeholders' interests with

[239] Mitchell, R. K., Agle, B. R., & Wood, D. J., "Toward a Theory of Stakeholder Identification and Salience. Defining the Principle of Who and What Really Counts", Academy of Management Review, Vol. 22, No. 4, (1997), p. 853-866.

[240] Reed, D. "Stakeholder Management Theory: A Critical Theory Perspective", Business Ethics Quarterly, Vol. 9, No. 3, (1999), p. 453-483.

[241] Simone de Colle, *Supra note 230*, p. 301-302 and www.slideshare.com

the goal of building understanding and trust on issues of mutual interest.[242] The following dimensions of stakeholder governance/stakeholder engagement have been identified by prior researchers:[243]

1. The type of stakeholders involved (stakeholder group and composition)
2. The scope of participation (i.e. issues, areas of engagement like operational, managerial and strategic issues)
3. The formal instruments (inward oriented reports, dialogues and outward oriented collaboration and joint learning).
4. Levels of engagement (participation in the decision making)

Among these, the level of stakeholder engagement and participation in decision-making, or 'stakeholder power' is basic question with regard to stakeholder governance. In the 'Citizenship Participation Ladder' by Arnstein (1969), which is one of the earliest models in the area of public services, distinguished citizen participation on a continuum that spread from Manipulation, Information, Consultation, Partnership, Delegated Power, to Citizen Control.[244] On each ladder the level of stakeholders' impact and influence varies accordingly. A recent research describes the level of engagement as: monitor, inform, transact, consult, involve, collaborate, empower.[245]

Few companies engage stakeholders by empowering or engaging them in decision making and in the majority of cases stakeholders' engagement is limited to opinion sourcing, discussions, etc.[246] Engaging them will obviously give them the chance to decide on the money and asset which doesn't legally belong to them. If they participate in the decision making process, a controversy may arise as they may pursue their own interest. Another scenario could be managers and directors may consider stakeholders participation in decision making as a power sharing and

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[242] *Supra note 238*
[243] Erik G. Hansen and Heiko Spitzeck, Stakeholder Governance: An Analysis of BITC Corporate Responsibility Index Data on Stakeholder Engagement and Governance, (A Doughty Centre for Corporate Responsibility, 2010), p. 5, 6 and 7
[244]Arnstein, Sherry R. , "A Ladder Of Citizen Participation," Journal of the American Planning Association, Vol. 35, No. 4, (1969), P. 216 — 224 cited in Hansen and Spitzeck, *Supra note 243*, p. 7
[245] Hansen and Spitzeck, *Supra note 243*, p. 7
[246] Hansen and Spitzeck, *Supra note 243,* p. 24

scramble. These may be some of the reasons for companies' reluctance to empower stakeholders. The last reason could be a legal prohibition on stakeholder board membership.

The basic point shouldn't, in the writer's view, be whether stakeholders are participating in the decision making process but whether in whatever degree of stakeholder engagement the corporate governance is taking their interest into account and responding to it.

In general, stakeholder reporting, survey, dialogue forum and partnership can be taken as means of stakeholder engagement while the level of engagement being different from company to company.

3.4 "Enlightened Shareholders Value" Model

The shareholder and stakeholder models of corporate governance discussed above are the dominant theories that have been debated for some time. It has been asserted that these models are intellectual constructs which do not capture reality in all its complexity.[247] This means that there is no purely shareholder or purely stakeholder model that contains all the characteristics defining both models.

Through time came the convergence of the two approaches in another theory known as an "enlightened shareholders value" approach. This theory is somewhat a compromise between the two and argues that the decisions of the board should align the interest of shareholders profit maximization with the interest of stakeholders, for the long term profit maximization of shareholders and sustainability of the company.[248] The "enlightened shareholders value" approach merges elements of the shareholder primacy and stakeholder models. In other words, it means that corporations should generate profit for their shareholders but when they are doing this, it should be having regard to the long term impact of that profit generation. This approach has been seen as a possible "third way" alternative to strict shareholder primacy, on the one hand, and to a pluralist vision of corporate social responsibility that elevates non-shareholders to the same plane as shareholders.[249] A short-term focus on current share price even when that objective entails immediate or longer-term negative effects on non-shareholders contrasts with

[247] Salacuse, *Supra note 165*
[248] Gebeyaw Simachew, *Supra note 43*, p.8
[249] David Millon, Enlightened Shareholder Value, Social Responsibility, and the Redefinition of Corporate Purpose Without Law, (Washington and Lee University, Working Paper, 2010), p.3

this approach to management.[250] This model looks like the standard Anglo-American corporate governance model to some degree.[251]

The "enlightened shareholder value" principle was introduced in the 2006 UK Companies Act. Under the Act, management's ultimate responsibility is to the shareholders, but it is with regard to long-term consequences, employee interests, relations with suppliers, customers, and others, impact on the community and environment, and the company's ethical reputation where that objective should be pursued.[252] Section 172 of the Companies Act in defining the fiduciary duties of directors goes as follows:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to -

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company."[253]

These are list of principles that directors of companies are required to consider in discharging their duties. [254]

This Companies Act of 2006 was the result of the efforts to reform the UK corporate governance model, inspired collectively by the Cadbury Committee Reports of 1992; the Greenbury Committee Report of 1996; and the Hampel Committee Report of 1998, which united the

[250] *Ibid*, p.1
[251] Virginia Harper Ho, Enlightened Shareholder Value: Corporate Governance Beyond the Shareholder-Stakeholder Divide, (2010), p.20
[252] Millon, *Supra note 249*, p. 2
[253] *See* U.K. Companies Act of 2006, Section 172
[254] Richard Williams, "Enlightened Shareholder Value in UK Company Law", UNSW Law Journal, Vol. 35(1), (2012), p.361.

preceding into a Combined Code.[255] It was the Company Law Review Committee which undertook a wide-ranging review of UK company law during the late 1990s and early 2000s that recommended the inclusion of the "Enlightened Shareholder Value" principle in the Act.[256] Whether the concept introduced in the Act falls in the Anglo-American "primacy theory" or the Continental European "pluralist theory "is being debated. While some scholars consider that the enlightened shareholder value concept embodied in section 172 of the Act is no more than a re-affirmation of the traditional common law shareholder primacy under a different appearance, others believe that it inches towards a 'pluralist theory' of continental European tradition.[257] There are also others who say that it is the convergence of principles from both the traditional 'primacy theory' and 'pluralist theory'.[258] The writer is of the opinion that this approach should be taken as a convergence of principles from both models rather than taking it as a modified form of either of the two models. This is because it takes some principles from both models and tries to compromise the two seemingly competing approaches.

This model has begun to get acceptance even in the US which is characterized by the Anglo-American model of corporate governance. More than 25 States in the United States enacted "constituency statutes" which permit boards to take into account the concerns of stakeholders when they make their decisions.[259] We have also seen that The United Kingdom Companies Act in similar way requires boards to promote the interests of stakeholders when they make decisions.[260] These instances can be taken to show that there is now convergence of corporate governance models.

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[255] Collins C Ajibo, "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory", Birkbeck Law Review, Vol. 2 (1), p.43 and 44

[256] Williams, *Supra note 254,* p.361

[257] Ajibo, *Supra note 255*, p.37

[258] Ajibo, *Supra note 255*, p. 37

[259] Sarrat, *Supra note 217*, as cited in Gebeyaw Simachew, *Supra note 181*, p. 32

[260] The 2006 Companies Act of UK, Sections 172(1) which provides companies' directors have the responsibility to promote the interests of employees, customers, suppliers and the effect of companies operations on the community and the environments.

CHAPTER FOUR

4. Shareholder or Stakeholder Model of Corporate Governance: Which One Should Ethiopia Choose?

4.1 Shareholder vs. Stakeholder Models Compared

The two corporate governance models have been discussed in the previous chapter. Below is a brief comparison of the two models from different perspectives as this could help to further understand the characteristics of both models.

Firm Purpose

One major difference between the shareholder and stakeholder models is the meaning they accord to the purpose of a firm. As discussed earlier, maximizing shareholder's value and increasing profitability is the prime purpose of a firm in the shareholder model. The stakeholder model differs in this regard in that it doesn't agree with the former's assertion that a corporation should only serve the interests of its shareholders. This model argues that a corporation should take into account the interests of other stakeholders who can affect or be affected by the corporation's activities to meet its objective.[261] It considers firms to be social institutions, not just networks of private contracts or the property of their shareholders.[262] This difference in objective results from the difference in corporations' ownership i.e. companies in the shareholder model are in widespread shareholdings by many private individuals while in the 'stakeholder' model the corporations are more in concentrated ownership by one or more large shareholders with strategic motivation for the ownership.[263]

Board type and composition

The other difference is in the structure of boards. The shareholder model usually uses a single-tier board, while a two-tier board is more common in Germany, Eastern Europe, France and

[261] Gebeyaw Simachew, *Supra note 43*, p.8
[262] Streeck, Wolfgang, German Capitalism: Does It Exist? Can It Survive?, MPIfG Discussion Paper, 95/5 (1995), p. 9. as cited in , Ali Köşklü, Corporate Governance Systems: Shareholders Versus Stakeholders, (2008), p.3 available at, http://www.internationallawoffice.com/newsletters/detail.aspx?g=14a54b01-d681-4cd1-b836-4087c333198a
[263] Hoffmann, *Supra note 36*

certain other European countries.[264] German corporations have a two-tiered board structure consisting of a management board (composed entirely of insiders, that is, executives of the corporation) and a supervisory board (composed of labor/employee representatives and shareholder representatives). This is not the case in the Anglo-American Model which follows a single-tier board that includes both "insiders" (executive directors) and "outsiders" (non-executive or independent directors).[265]

Internal Controls and Auditing

In the Anglo-American model, which is characterized by the dispersed ownership of companies, the control mechanism is referred to as either 'outsider-external' or 'market based'.[266] But companies in Germany rely on internal control mechanisms through the hands of banks and in the two-tier board system.[267]

Share Ownership

The concentration of ownership is the other difference between the two models. Anglo-American companies that follow the shareholder model exhibit a dispersed ownership with a highly developed capital market structure and institutional shareholders holding large amounts of shares.[268] 0n the other hand,   almost all large German corporations have a sole shareholder or a few major shareholders which may be other companies, wealthy families, banks or insurance companies, other enterprises being the most important shareholders among these.[269]

In general, to better understand the two approaches, the key distinction between the two models from different perspectives can be summarized as follows.[270]

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[264] Köşklü, *Supra note 262*
[265] Three Models of Corporate Governance from Developed Capital Markets, (EWMI/PFS Program / Lectures on Corporate Governance, 2005), p. 3, available at http://www.emergingmarketsesg.net/esg/wp-content/uploads/2011/01/Three-Models-of-Corporate-Governance-January-2009.pdf
[266] Köşklü, *Supra note 262*
[267] Köşklü, *Supra note 262*
[268] Köşklü, *Supra note 262*
[269] Köşklü, *Supra note 262*
[270] Ayuso and Argandona, *Supra note 183*, p. 3 and Köşklü, *Supra note 262*

Perspective	Shareholders perspective	Stakeholders perspective
Purpose	• Maximizes shareholder value (wealth) and looks after shareholder interests • Seeks profitability and efficiency • Hard-nosed and commercial	• Pursue multiple objectives of parties with different interests • Looks after all stakeholder interests, especially public • Less concerned about profit than value for money • Looks for survival, long-term growth and stability
Ownership type	• Wide ownership where ownership is scattered with managers given a great deal of freedom, but subject to market forces, such as takeovers and proxy fights • All shareholders need protection, with close attention to management actions	• Ownership concentrated with a few people with strong power over management, sometimes through an executive chairman • Minority shareholders poorly protected and need independent director support
Board structure and composition	• Single –tier board • Executive and non-executive directors sit together	• Two-tier board • Supervisory board consists solely of non-executive directors and a lower-level management board consists of full-time managing directors • Supervisory board totally independent from management board
Governance structure	• Principal agent model (managers are agents of shareholders)	• Team production model
Governance process	• Control	• Coordination, cooperation and conflict resolution
Residual risk holder	• Shareholders	• All stakeholders

4.2 Pros and Cons of the Models

We have seen in the previous sections that the two models have some conflicting interests. It is claimed that as money can't be spent twice, companies my serve one, say workers, at the expense of the other (shareholders).[271] More payment to the workers means less payment to shareholders in terms of dividends. Stakeholder approach demands directors and managers to see beyond the interests of shareholders and work and care for others interested in the company's activities (stakeholders). So the advantage and disadvantage that both models contain will be dealt respectively in the following paragraphs.

4.2.1 Pros and Cons of the Shareholder Model

One advantage of the Anglo-American Corporate Governance model is its help in ensuring allocation of resources. Some people claim that if markets and institutions are well developed and competitive, such type of corporate governance ensures an efficient allocation of resources.[272] The other obvious advantage is its maximization of shareholder value in the sense that the shareholders will get a better investment return and the share price will also rise due to the company's focus on short term profit maximization strategies.

Despite the above benefits the shareholder model has some problems which mainly stem from the model's focus on short-term strategy and disregard of other stakeholder interests. One problem with the shareholder model is that it can lead to poor or unsustainable business practice.[273] In the hopes of making short-term profits, managers may engage in activities that may put the company at a future risk. Companies often take on much more risk than they otherwise would in the shareholder value model and such risk may put the company in bankruptcy and collapse.[274] Maximizing value in the short-term rather than in the long-term can have negative repercussions on the firm.[275] The other problem with the shareholder model is its disregard of employees and customers which have a direct influence on the success of the

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[271] A. Simpson, Shareholders and Stakeholders: "the Tyranny of the or", (A Paper Presented at Asia Corporate Governance Roundtable Third Meeting, 2001), p. 1

[272] Allen and Zhao, *Supra note 176*

[273] Gregory Hamel, Negatives of Maximizing Shareholder Value. available at http://smallbusiness.chron.com/negatives-maximizing-shareholder-value-36146.html

[274] Wikipedia, The Free Encyclopedia, available at www.wikipedia.org

[275] *Supra note 169*

company.[276] What the company's managers do to cut cost and increase profit might potentially hurt the customers and employees of that company and this will damage its long term value. Company managers may engage in fraudulent activities to make the company seem profitable and this conduct hurts the transparency that should exist.[277] Corporate involvement in politics is the other problem with this model.[278] As the government taxes and regulations may affect the shareholder value, corporations may involve in politics to have a legislation passed in their favor.

4.2.2 Pros and Cons of the Stakeholder Model

When we come to the stakeholder model, it may have some advantages in allocation of resources too. In cases where markets and institutions are not perfect and competitive this view of corporate governance can lead to a superior allocation of resources than the narrow view. The other cited benefit is the one discussed in chapter three in relation to stakeholder theory. Paying attention to stakeholder groups has intrinsic (moral) advantage. In addition to this, though we don't find enough empirical evidence, responding to stakeholder groups has something to do with improving firm performance.

One problem with the stakeholder model is the discretion that it accords to managers. The fundamental problem in stakeholder approach is how to define and identify relevant stakeholders.[279] Even though stakeholder theorists allege that corporations should take into account the interests of all stakeholders, they often fail to provide the explanation of how to make tradeoffs among different stakeholders with inconsistent and even competing interests.[280] What rewards should be given to them and by what criteria they should be rewarded or rejected is vague by itself. Making directors accountable to multiple stakeholders increases their discretion.[281] It gives them the discretion to decide on identification of stakeholders and the discretion as to which claim to accept and which interests to pursue. Such discretion may be abused and used against the interest of shareholders. Related with this is the problem of diversity of stakeholders' needs and the pursuance of multiple goals by managers. Stakeholders have

[276] Hamel, *Supra note 273*
[277] Wikipedia, *Supra note 274*
[278] Hamel, *Supra note 273*
[279] Pascual Berrone, "Does Stakeholders Management have a Dark Side?", Journal of Business Ethics, (2008) , p. 3
[280] Shao, *Supra note 1*, p.8
[281] Berrone, *Supra note 279,* p. 5 & 6

different and sometimes conflicting needs which put managers in a situation where they have to pursue different goals.[282] A decision to use environmentally friendly material, for instance, may cost more money which will be against the shareholders' interest. It is because of this that some critics claimed that pursuing multiple goals increases complacency and muddles the organization's identity.[283]

The other problem with the stakeholder model relates to the disregard of the corporation's objectives. The efficiency of the company would be impaired when directors have multiple objectives to think about.[284] Following a stakeholder approach requires managers and employees to take into account and care for the interests of identified stakeholders and this may divert their attention and efforts from the corporation's main objective.[285] Such an attempt to satisfy other interest groups requires time and effort. And this makes managers give less attention to the corporation which in effect results in decreased productivity which will directly affect shareholder's interest.

Thirdly, in adopting a stakeholder model of corporate governance, there is shareholders' money involved in the process. More payment to employees or suppliers mean diminished dividend to shareholders. The money that is spent on other environmental and social activities as part of responding to stakeholder's interests will be done at the expense of shareholders. So, following stakeholders approach comes at the cost of shareholders' money which contradicts with the latter's ambition for adequate investment returns. There may also be wastage of resources of the company in meeting the stakeholders' demands.

The last problem with the stakeholder model comes from the risk that managers and directors pose to shareholders. Managers and directors under the guise of promoting stakeholders approach and engaging stakeholders may pursue their own pride and reputation on the face of stakeholders and the community. This may result in disregard of shareholders' interests and sometimes may go to the extent of favoring the stakeholders at the expense and cost of shareholders money.

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[282] *Supra note 169*
[283] *Supra note 169*
[284] www.lawteacher.net
[285] Berrone, *Supra note 279*, p. 5 & 6

4.3 Conciliation between the Two Models (Balance between Ethics and Economics).

It has been discussed earlier that shareholders and other stakeholders have diverse and conflicting interests which should be compromised in some way. Shareholders short-term maximization of wealth leads to system abuses while on the other end stakeholders' interest maximization can lead to waste and diversion of corporation's assets which is not liked by shareholders.[286] So there is a conflicting interest that has to be balanced. Such conflicting interest may be between shareholders and stakeholders as a whole or it can even be among the different stakeholders themselves.

Balance between the interests of stakeholders is essential to the long-term existence of a corporation as fair and balanced stakeholder's perspective results in long-term shareholder maximization value. [287]Balancing of stakeholder interests is the process of assessing, weighing, and addressing the otherwise competing interests of those who have some kind of stake in the actions of the organizations.[288] One function of the corporate governance regime is to mediate between the competing claims different groups have on the corporation.[289] But how is this done becomes a huge problem which by itself becomes difficult and complex process.

Corporate managers and directors should reconcile shareholders' and stakeholders' interests by adopting policies and strategies that try to achieve both economic, social and environmental standards.[290] Major policy and strategic decisions that are passed should be weighed both from the shareholder's and stakeholder's perspective. One step towards balancing interests is, as suggested in one conference, to replace the "or" with "and" in our "shareholder or stakeholder" thinking of corporate governance.[291] This idea signals the importance of both shareholders, who provide the financial resource, and the stakeholders, whose contribution is expressed in terms of human and at times physical capital.

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[286] Carrillo, *Supra note 34*, p. 99

[287] Carrillo, *Supra note 34*, p. 98

[288] Scott J. Reynolds et al, "Stakeholder Theory and Managerial Decision-Making: Constraints and Implications of Balancing Stakeholder Interests", Journal of Business Ethics, Vol. 64, (2006), p. 286

[289] Simpson, *Supra note 271*, p. 1

[290] Simpson, *Supra note 271*, p. 99

[291] Simpson, *Supra note 271*, p. 99

A compromise between the pursuit of the various interests should be found as the interest of stakeholders is various and contradictory.[292] This compromise could be trusted to managers, politicians, an articulated management board, where the different instances may be represented.[293] In the stakeholder model, a corporation can be viewed as a community and it must be run as such.[294] This may be explained in the same manner the government balances the various interests in the community; it has to be done the same way in balancing the interests of stakeholders.

Keeping the balance between shareholder's and other stakeholder's interests depends mainly, at least to the writers view, on the strength and quality of the corporate governance. One way of doing this should be to stop thinking in a "shareholders vs. stakeholders" way of governance as if they have conflicting interests which cannot be reconciled. It is clear that the main interest of shareholders is profit maximization. Stakeholder approach doesn't disregard this interest but further asserts that corporations should have other objectives to meet other than profit maximization. These other objectives indirectly contribute to the wealth maximization purpose of corporations as claimed by the shareholder model. What the writer is saying is that shareholders also benefit in adopting the stakeholder approach. One valuable asset in the business world could be the trust that companies have in the society. Consumers, suppliers, distributors and the community surely want to transact with companies they trust and which takes into account their interest.

4.4 The OECD Principles of Corporate Governance on the Issue.

The OECD Principles of Corporate Governance, which have become international benchmarks for policy makers, investors, corporations and other stakeholders worldwide, were endorsed in 1999 by OECD Ministers.[295] The Principles are intended to assist OECD and non-OECD governments and other business entities to improve their corporate governance systems.[296] It has in total some 6 principles of corporate governance namely:[297] ensuring the basis for an effective corporate governance framework, the rights of shareholders and key ownership functions, the

[292] Chilosi and Damiani, *Supra note 175*, p. 2
[293] Chilosi and Damiani, *Supra note 175*, p. 2
[294] Chilosi and Damiani, *Supra note 175*, p. 2
[295] The OECD Principles of Corporate Governance, *Supra note 13*, p. 3
[296] The OECD Principles of Corporate Governance, *Supra note 13*, p. 11
[297] *See* Generally the OECD Principles of Corporate Governance, *Supra note 13*

equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and the responsibilities of the board.

One issue that is dealt by the OECD in formulating its Principles of Corporate Governance is regarding the shareholder and stakeholder models of corporate governance.[298] The Principles tried to reconcile the debate between the two models by stating on the one hand that the corporate governance framework should ensure, protect and facilitate the exercise of shareholders' rights and the equitable treatment of all shareholders in its articles I and II and on the other hand that the corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements in its article IV. [299] The last statement has an implication that the corporate management is not required to take account of it in its decisions if the right that a given stakeholder has is not established by law.[300]

In addition to maintaining equitable treatment of shareholders, the principles require that the corporate governance framework recognizes the rights of stakeholders established by law or mutual agreements.[301] The principle requires that stakeholders get effective redress for violation of their rights, employee participation should be developed and generally stakeholders should have a meaningful say in the corporate governance process.[302] This shows that the OECD Principles of Corporate Governance emphasizes the importance of both shareholders and stakeholders. Because of this, there are some people who state that the OECD Principles of Corporate Governance take the position of the "enlightened shareholders value" approach in the corporate governance model debate.[303]

4.5 The Corporate Governance Models of Selected Countries

This section is about the corporate governance models of selected countries of the world. It discusses the corporate governance models of countries like US, UK, Germany and Japan for comparative purpose. These countries are selected mainly due to their global influence and the representative role they play with regard to the competing models of corporate governance.

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[298] *Ibid*
[299] The OECD Principles of Corporate Governance, *Supra note 13*, Art. I, II and IV.
[300] Salacuse, *Supra note 165*, p. 34
[301] The OECD Principles of Corporate Governance, *Supra note* 13, p. 21
[302] The OECD Principles of Corporate Governance, *Supra note 13*, p. 21
[303] Gebeyaw Simachew, *Supra note 43*, p.8

US

The United States is the primary follower of the shareholder model of corporate governance. This is reflected in the Principles of Corporate Governance Prepared by the American Law Institute (ALI). This principle states that "…a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain."[304] The shareholders elect a management board (directors) whose responsibility is representing the primary interest of the shareholders which is increasing their wealth.[305] The boards of US companies are unitary unlike Germany and hold the most fundamental powers like the authority to sell the corporation.[306] The Chief Executive Officer (CEO) serves as the chairman of the board of directors and directors are accountable to the shareholders who elected them.[307] Though the American corporate governance takes maximization of shareholder value as the primary goal of a firm and its management, there is a recent development towards the continental Europe's stakeholder model. A "constituency statutes" which permit boards to take into account the concerns of stakeholders when they make their decisions is enacted in more than 25 States of the United States.[308]

UK

The roots of the UK corporate system and law, which has influenced its former colonies, are based on the philosophy of individualism and freedom of contract.[309] Like the United States, the UK currently uses a one-tier board structure, with elected non-executive directors and independent auditors used as a safeguard of accountability for shareholders.[310] The unitary board has a collective responsibility and the chief executive and chairman have separate duties as so is

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[304] Salacuse, *Supra note 165*, p.22

[305] Jackson Katharine V, "Towards a Stakeholder-Shareholder Theory of Corporate Governance: a Comparative Analysis", Hasting Business Law Journal, Vol. 7, Issue 2, (2011), p. 312 (P. 309-392) as cited in TEKİN, *Supra note 211*, p. 243

[306] Raber Roger and Lajoux Alexandra, The United States of America, in the Handbook of International Corporate Governance: A Definitive Guide, (2nd Ed., 2009), p.146 as cited in TEKİN, *Supra note 211*, p. 243

[307] Barnett Abigail and Maniam Balasundram, "A Comparison of US Corporate Governance and European Corporate Governance", The Business Review, Cambridge, Vol. 9, Issue 2, (2008), P. 24 as cited in TEKİN, *Supra note 211*, p. 243

[308] Sarrat, *Supra note 217*, as cited in Gebeyaw Simachew, *Supra note 181*, p. 32

[309] TEKİN, *Supra note 211*, p.245

[310] TEKİN, *Supra note 211*, p. 245

the powers of the executive and independent non-executive directors.[311] Apart from the board, there are various independent audit, remuneration and nomination committees.[312] Supervision of management and ensuring that shareholders' interests are represented is the primary functions of non-executive directors.[313] In addition to this, the non-executive directors have significant say in strategy development, offering criticism and constructive thought and ensuring that the objectives and goals of the company are met.[314]

A recent development in the UK corporate governance is its tendency to include elements of the stakeholder model of corporate governance and deviate from the traditional Anglo-American model. It has been stated that the shareholder capitalism in the UK is beginning to depart from its American counterpart and develop its third way, a long-term enlightened shareholder value perspective with strong elements of European stakeholder thinking. [315] This is reflected in section 172 of the 2006 UK Company Act.

Germany

Germany is one of the countries which follow the stakeholder model of corporate governance. In addition to protection of shareholders' interests it also considers the interests of other stakeholders of the company. The German system can be described as "cooperative relationships among banks, shareholders, boards, managers and employees in the interests of labor peace and corporate efficiency".[316] The two-tier board structure, which is composed of a separate lower; management board ("Vorstand") and the upper; supervisory board ("Aufsichtsrat"), is a specific feature of the German model of corporate governance.[317] Unlike the supervisory board which consists entirely of outside directors, the management board is comprised completely of executive directors.[318] Supervisory board, which makes major decisions of the company, also

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[311] TEKİN, *Supra note 211*, p. 245
[312] TEKİN, *Supra note 211*, p.245
[313] TEKİN, *Supra note 211*, p.246
[314] TEKİN, *Supra note 211*, p.246
[315] *See* Generally Cynthia A. Williams and John M. Conley, "An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct", Electronic Journal, (2004), available at : http://www.researchgate.net
[316] Abigail and Balasundram, *Supra note 307*, p.27 as cited in TEKİN, *Supra note 211*, p. 247
[317] TEKİN, *Supra note 211*, p.247
[318] Tricker Bob, Corporate Governance: Principles, Policies and Practices, (2nd Ed., Oxford University Press, 2012), p. 52 as cited in TEKİN, *Supra note 211*, p.247

appoints, dismisses, advises and supervises the members of the management board.[319] Remuneration for the management board is also fixed by the supervisory board.[320] The management board on the other hand is in charge of the day-to-day activities of the company.[321] It represents the company in its business dealings and legal affairs.[322] The German Stock Corporation Code (§ 77 (1) (2)) allows and even obliges the management to take into account the interests of other "stakeholders" like the employees, the creditors of the firm and the general public.[323] This separation between the management board and the supervisory board is mandatory for stock corporations and large limited liability companies.[324]

The co-determination regime is the other specific feature of German corporate governance law.[325] The German corporate governance system has a means of representing employee interests. One way to show this is the fact that a minimum of half of the supervisory board members have to be employee or trade union representatives under a co-determination structure in the German companies.[326] Banks are also present in the supervisory board representing shareholder or lender interests.[327]

Japan

Japan follows the Stakeholder Model alongside Germany and many European countries. Shareholders own the securitized assets of the company in shares and have a residual claim in the company.[328] But unlike the US and UK, firms in Japan are not concerned with only maximization of shareholder's value but with a broader group of stakeholders, including

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[319] Strenger Christian, Overview and Current Issues in Germany, in The Handbook of International Corporate Governance: a Definitive Guide, (2nd Ed, 2009), p.193 as cited in TEKİN, *Supra note 211*, p. 247
[320] Theodor Baums, Corporate Governance in Germany: System and Current Developments, (Universität Osnabrück) , p. 4
[321] Wei Yuwa, Comparative Corporate Governance, Kluwer Law International, (2003), p.16 as cited in TEKİN, *Supra note 211*, p. 247
[322] Baums, *Supra note, 320*, p. 5
[323] Baums, *Supra note, 320*, p. 5
[324] Baums, *Supra note, 320*, p. 4
[325] Baums, *Supra note, 320*, p. 4
[326] Bob, *Supra note 318*, p.52 as cited in TEKİN, *Supra note 211*, p. 247 & 248
[327] Abigail and Balasundram, *Supra note 307*, p. 29 as cited in TEKİN, *Supra note 211*, p.247 and 248
[328] Takaya Seki & Thomas Clarke, "The Evolution of Corporate Governance in Japan: The Continuing Relevance of Berle and Means"*,* Seattle University Law Review, , Vol. 37:717,(2014), p. 720

employees, suppliers, customers in addition to shareholders.[329] Corporate governance in Japan has traditionally been concerned with a broader view of which one way of articulation is that firms are run in such a way that society's resources are used efficiently by taking into account a range of stakeholders.[330] Managers in Japan do not owe a fiduciary duty to shareholders.[331]

The Japanese corporate governance system is based on what is known as "keiretsu" system. "keiretsu" "is a type of informal business group involving a set of companies with interlocking business relationships and shareholdings.[332] With the distinctive feature of tendency for cooperation, the Japanese model is characterized by long-term investment strategy and a close relation with industrial and financial sectors.[333] In the Japanese system, there is a close connection among economic units through the mechanism of cross-shareholding, forming a corporate group.[334]

In Japan, we have Audit and Supervisory Board (Kansayaku-kai) and the Board of Directors (Torishimariyaku-kai) who control the company's affairs.[335] The"kansayakus" who should include members outside the company are Audit and Supervisory Board Members performing a role similar to audit committees and are becoming more outspoken.[336] Supervising board members and auditing financial statements alongside the independent auditor are among the primary duties of the Kansayakus.[337] The Kansayakus, however, have no voting rights for decisions at the board meetings unlike their director colleagues.[338]In addition to the audit and supervisory board members, there are also directors appointed by the shareholders. Directors have the responsibility to look after the company's assets and serve the best interest of the company.[339]

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329 Allen and Zhao, *Supra note 176*
330 Allen and Zhao, *Supra note 176*, p. 2
331 Allen and Zhao, *Supra note 176*, p. 2
332 Wikipedia, *Supra note 274*
333 Natalia Victorovna Kuznetsova, "Keiretsu: Past, Present and Future", World Applied Sciences Journal 26 (12): 1569-1573,(2013), p. 1569
334 *Ibid*
335 *See* Seki & Clarke, *Supra note 328*, p. 721
336 Seki & Clarke, *Supra note 328*, p. 719
337 Seki & Clarke, *Supra note 328*, p. 719
338 Seki & Clarke, *Supra note 328,* p. 719
339 Seki & Clarke, *Supra note 328*, p. 720

4.6 The Current Corporate Governance Model of Ethiopia.

Before dealing with the question as to which model of corporate governance should Ethiopia adopt, we should first explain Ethiopia's corporate governance environment in light of the two models of corporate governance. We should not normally expect a statement that says Ethiopia follows this or that model of corporate governance. The existing laws of the country are the main source to find out which of the two models influenced Ethiopia's corporate governance.

To this end, when we look at the Commercial Code of Ethiopia, there is very narrow place for the engagement of stakeholders of a company in decision making and other form of engagement. Stakeholder model of corporate governance proposes directors and managers of a company to be accountable not only to shareholders but also to stakeholders of that company. But the Commercial Code of Ethiopia provides that directors are liable to the company and its creditors which in no way include other stakeholders.[340]

In addition to the above, one way of stakeholders engagement in a company's activities is through board representation. Opposed to this, the Commercial Code of Ethiopia reserves the position of board of directors only for members of the company.[341] In a similar fashion, article 5 of the National Bank of Ethiopia directive on Licensing and Supervision of Banking Business prohibits bank employees' representation in board membership.[342] But contrary to this directive The Banking Business Proclamation No. 592/2008 under its article 14 (4) (f) provides that the National Bank of Ethiopia shall determine the maximum number of employees who may be members of the board of directors. We can see that there is an apparent contradiction between the directive and the proclamation. Obviously, the proclamation is superior to the directive hierarchically so that the proclamation prevails over the directive by way of interpretation. But these two provisions of the proclamation and the directive should be reconciled in a way that shows the actual stand of the government on the issue of employee board representation.

When we come to board structure and composition, the board of directors is the main organ of corporate governance in the Ethiopian share company law. The two-level board structures

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[340] Com. Code. Art. 364 & 366

[341] Com. Code, Art. 347

[342] Licensing and Supervision of Banking Business Limits on Board Remuneration and Number of Employees Who Sit on a Bank Board, 2011, National Bank Directive No. SBB/49, Art. 5

composed of upper (supervisory board) and lower (management board) which exists in Germany is not recognized under Ethiopian company rules. Ethiopia rather follows a unitary board structure like America. This also strengthens the fact that it is the shareholder model that dominates the company law rules in Ethiopia.

We can thus conclude that our company law has adopted the traditional Anglo- American shareholders model of corporate governance. It then follows that our company law doesn't take into account the interests of stakeholders despite there are some means like government regulation which will indirectly protect stakeholders' interests. Implementing stakeholder form of corporate governance then seems to be left to the wills and commitments of the companies themselves in Ethiopia.

4.7 Which Model of Corporate Governance Should Ethiopia Choose?

A number of companies are being formed in Ethiopia by sale of shares to the public or as a result of privatization scheme. This corporatization process raises different issues of corporate governance. There are policy choices to be made and reforms to be implemented with regard to corporate governance as the concept has only recently got a wide attention in Ethiopia. One of the issues is the model of corporate governance that should be adopted by Ethiopia among the shareholder and stakeholder models.

Two things should be given due consideration by our policy makers before making a choice between the two models. Firstly, for some practical and historical reasons the two models are the dominant ones in the world so that Ethiopia's choice should be limited between the two. Developing an entirely new model of corporate governance for Ethiopia is difficult and unwise as is the case for other developing countries. For one thing, be it the shareholder or the stakeholder model, they have evolved through years of experience and business practice. Ethiopia doesn't have that experience as corporatization and corporate governance are of recent development. For another, Ethiopia should be wise in reaping the advantages of late-development so that after weighing the advantages and disadvantages of both models it should choose the appropriate elements to its own needs. Secondly, transplantation of one model of corporate governance in its entirety and without making the necessary adaptation would be inappropriate and difficult.[343] Just because a certain system has been successful in one country or group of countries doesn't mean that it will also be so in Ethiopia .So, transplantation without adaptation is not advisable.

The best approach then will be to choose some elements out of each model and apply to the country's needs. To do this, we have to see the economic condition, the business and corporate culture of our country as each model requires an institutional and legal infrastructure. In the next paragraphs, Ethiopia's corporate governance system will be viewed from the characteristics of both the shareholder and stakeholder models to know whether we have the environmental foundation for both models. And finally, an attempt will be made to show as to which model would be appropriate for Ethiopia especially from the perspective of firm purpose.

One characteristic of the shareholder model is its priority to market regulation. There is an active `market for corporate control in the shareholder model. There is also a developed capital market through which stock and other financial assets are traded. When we come to the stakeholder model, it gives priority to stakeholders control unlike the shareholder model. The capital market is not developed in the stakeholder model like the shareholder one. Ethiopia doesn't have an organized capital market where shares and other securities are traded though there are some recent positive developments and recommendations.[344] So, it is the shareholder (stakeholder) control that is given a priority. There isn't also a developed market that can regulate itself and the corporate governance. When we see the above points, the current environmental foundation is not favorable for adopting the shareholder model.

The other characteristic in the shareholder model is the one that the owners of firms tend to have a transitory interest in the firm. The shareholders do not have a close relationship with the management of a company. But in the stakeholder model, the owners of firms tend to have an enduring interest in the company and often hold positions on the board of directors or other

[343] Salacuse*, Supra note 165*, p. 54

[344] See Fetsum Berhane, Horn Affairs-English, Posted on Saturday, June 6, 2015 @ 4:08 am, available at: http://hornaffairs.com/en/2015/06/06/ethiopia-establish-secondary-capital-market-year/, Tiruneh Legesse, "Establishing Financial Markets in Ethiopia: the Environmental Foundation, Challenges and Opportunities", JBAS, Vol. 4, No. 1,(2012), Araya Debesay and Tadewos Hareg-Work, Towards the Development of Capital Market In Ethiopia, available at: http://www.eeaecon.org/sites/default/files/publications/Araya%20and%20Tadewos_Towards%20the%20Development%20of%20Capital%20Market%20in%20Ethiopia.pdf

senior managerial positions. The relationship between management and shareholders is close and stable. There is also a mechanism through which employees exercise their right to influence key managerial decisions. When we come to Ethiopia, what we find is the characteristic of the shareholder model. Research indicates that there is a growing separation of ownership and control in Ethiopian share companies.[345] Not only this, we have seen under section 4.6 of this chapter that in Ethiopian banks, employees cannot be board members.

Board structure is the other difference between the two systems. By structure I mean the two-tier board type of the Continental Europe and the one-tier board structure of the Anglo-American system. The two-tier board system separates the managerial and supervisory functions, usually combined within the unitary board system, into two distinct organs. [346] The supervisory board in the two-tiered board system is mainly composed of outsiders. In this regard, the Ethiopian corporate governance structure resembles that of the US and UK in the shareholders model.

The above instances tend to show that the current institutional set up takes the characteristic of both the shareholder and stakeholder models. The next question will be which model is suitable for Ethiopia from the perspectives of firm purpose.

The shareholder model gives the primacy of shareholder rights over those of other stakeholders. The stakeholder model on the other hand provides that the management should give due attention to all the stakeholders of the company including shareholders. The preference for the shareholder as opposed to the stakeholder model of corporate governance appears to have some basis in the culture and public attitudes of the countries concerned.[347] The difference between the Anglo-American and Continental European positions on corporate purposes may be explained to some extent by the greater emphasis placed by the former on the individual and the latter on the community.[348] Individualism accords an individual a central role in the scheme of things. One study found Americans to be the most individualistic, achieving an individualism rating of 91 out of a possible 100.[349] The European continent on the other hand is communitarian as it tends to

[345] Fekadu Petros, *Supra note 48*
[346] Salacuse, *Supra note 165*, p. 38
[347] See generally, Jeswald W. Salacuse, "Corporate Governance, Culture and Convergence: Corporations American Style or With a European Touch?" Law and Business Review of the Americas, (2002)
[348] Salacuse, *Supra note 165*, p. 29
[349] Geert Hofstede, Cultures and Organizations: Software of the Mind, (1st Ed. USA, McGraw-Hill,1997)

emphasize the role and importance of the community.[350]There is also a difference in the way they believe in competitions where some countries believe that what leads to greater benefits to society is increased competition while others believe that it is increased cooperation.[351]

The above instances tend to show that we have to see the nature of our society, the national culture and public attitude in Ethiopia on the purpose of a corporation. Does the national culture in Ethiopia take as a corporate goal the maximization of shareholder value or stakeholder benefits? Some of these conditions require further research on the area. But certain facts are clear. Ethiopia is a multiethnic country with diverse culture, language and lifestyle. Ethiopia, with a score of 20, is considered a communitarian or collectivist society as opposed to individualist one.[352] In other words, community values are given priority over individual values. So, as far as national culture is concerned, it is the stakeholder model which is more suitable for the country's condition.

Despite the fact that Ethiopia is more conducive to the stakeholder model than the shareholder, total inclination to one model of corporate governance over the other doesn't seem to be appropriate. So, from the above points, I do recommend that Ethiopia should choose a middle ground that takes into account the elements of both the shareholder and stakeholder models for the following reasons.

Firstly, there is an erosion of the shareholder model in the world even in the countries who advocated it most. We have seen in chapter three and four that some 25 states in the US have enacted constituency statutes which allow boards to take into account stakeholder interests while making decisions.[353] This shows that there is now a growing credence in considering and responding to the interests of stakeholders' interests. It has also been noted that a long-term enlightened shareholder value perspective with strong elements of European stakeholder thinking has been adopted in England which shows that the shareholder capitalism in the UK is beginning

[350] Salacuse, *Supra note 165*, p. 30
[351] Salacuse, *Supra note 165*, p. 30
[352] Cheri Baker and Michael Campbell, Context Matters: An Ethiopian Case Study, Adapting Leadership Development Methods to Serve Different Cultures, (Center for Creative Leadership, 2013), p.5, available at www.ccl.org See also at http://geert-hofstede.com/ethiopia.html
[353] Sarrat, *Supra note 217*, as cited in Gebeyaw Simachew, *Supra note 181*, p. 32

to deviate from its American counterpart and develop its third way.[354] The introduction of section 172 of the 2006 UK Company Act reflects this fact. Not only these, OECD principles of corporate governance in its articles I, II and IV have stressed the importance of protecting shareholders' rights and other stakeholders' rights recognized by contract or law. What these trends tend to show is that countries are shifting to a middle ground to varying degree as far as corporate governance model is concerned. So, Ethiopia's corporate governance system should learn from these inclinations towards the middle ground.

Secondly, Ethiopia is eager in attracting foreign direct investment for her development. As a result of this, many companies are expected to come and invest in the coming decades. These companies have their own background in relation to the corporate governance model to which their specific country has adopted. This means that the companies have expectations that the corporate governance model of the host country is adaptive to the environment in which they have been operating. This makes it inevitable for Ethiopia to follow an eclectic approach that takes a middle position between the two models.

Thirdly, though stakeholder model seems appealing in its theoretical form, it has many problems which make its application difficult. One major problem in this regard is identification of stakeholders of a company. Selection of the relevant stakeholders of a company and the selection criterion is always problematic. This, in effect, greatly increases the discretion of boards of directors as to which stakeholders to accept and which to reject. Even when the relevant stakeholders are identified, the problem still remains when it comes to prioritization of stakeholder's interests. As the interests of stakeholders are diverse and sometimes conflicting, making a compromise among these interests is a difficult task for the company's management.

Fourthly, the psychology and attitudes of Ethiopians towards business is one challenge. The shareholders of Ethiopian companies may not feel good when they are told that their company needs to consider the interests of those stakeholders that do not have any monetary contribution. There may be a tendency to consider stakeholders of companies as outsiders who do not contribute to the success or failure of companies. The shareholders may consider that the company belongs to them and other stakeholders should not be heard since it is their money that

[354] See Generally Williams, et'al, *Supra note, 315*

is invested. The other challenge is the so called "kiosk mentality" among Ethiopian businessmen. Short term profit seems to be the prime purpose of many of those Ethiopians who engage in business. It has been discussed previously that if a company is to create long term value for its shareholders, it shouldn't disregard the stakeholders and limit itself in activities that aim only short term profit. It should rather consider all the stakeholders who can affect or be affected by the company's activities. But such consideration for the long term value of companies may be challenged by the shareholders.

So, neither of the approaches is convincing in the sense that the shareholder approach focuses on implementation but neglected justification, and it is vice versa for the stakeholder approach in addition to their problematic arguments.[355]Adopting shareholder value maximization as a prime purpose of Ethiopian firms disregarding stakeholders' interests is not advisable and has negative consequences. On the other hand, adopting a pure stakeholder model of corporate governance in Ethiopia is also not advisable. Those countries which adopted the stakeholder model did so because their corporate culture, history and economic condition allowed them to do so. We do not, for instance, have network based businesses that is manifested by close relationship and shareholding among different banks, industries and employees.

Finally, if Ethiopia should take a middle ground between the two models, where can that middle position be found? It is my view that the middle ground between the shareholder and stakeholder models can be found in the "enlightened shareholder value" approach which is recently adopted in England. This is suitable because on the one hand, trying to keep the balance, it takes the interests of both the shareholders and other stakeholders into account. The approach states that the decisions of the board should align the interest of shareholders profit maximization with the interest of stakeholders. On the other hand it also weighs the decision of boards from the long term impact on the company, the community and the environment.

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[355] http://www.lawteacher.net/free-law-essays/business-law/criticisms-of-shareholder-and-stakeholder-debate-business-law-essay.php

CONCLUDING REMARKS

Corporate governance can play a positive role in corporate performance and output. The fundamental question that arises when choosing among the available governance approaches is: should corporations address the interest of only shareholders? or should they also look beyond that and take into account the interests of other stakeholders? In response to this, it has been discussed in the paper about the so called "shareholder" and "stakeholder" models of corporate governance. While shareholder model argues that corporate governance should focus on addressing the interest of shareholders only, stakeholder model rejects this view and forwards a counter argument in that corporate governance should engage and take into account other stakeholders who have a stake in the company. This same question of firm purpose has been raised and discussed in relation to Ethiopian corporate governance.

It has been found in the paper that total inclination to one form of corporate governance over the other is not advisable. There is no pure shareholder or stakeholder model of corporate governance that squarely fits the theoretical characteristics of the two models. There is also convergence of corporate governance models in the world. It has been suggested in the paper that after weighing both models of governance, Ethiopia should choose a middle ground by taking important components of both models in to account. Specifically, the "enlightened shareholder value" model has been proposed as an appropriate model.

It has also been discussed that adopting one or the other model has some adverse effects on the interest of shareholders or other stakeholders. The debate between the two models invites tensions between choosing maximizing shareholders' value or focusing on stakeholders' interests. There exists a conflict of interest between shareholders and other stakeholders and even among stakeholders themselves. These two seemingly conflicting approaches need to be reconciled by the corporate governance itself. It has been argued in the paper that such conflict of interest could be compromised and reconciled by the corporate governance system.

Adopting stakeholder approach to corporate governance is not only good for the interest of the stakeholders but it also is decisive for the company and its shareholders. When we take into account the interest of other stakeholders, shareholders long-term interests are also benefited.

Increasingly, consumers prefer to buy products from companies they trust; suppliers are interested in business partnerships with companies they can rely on; employees rather work for companies they respect; large investment funds favor socially responsible firms; and most respected NGOs prefer to cooperate with companies conciliating their investment interests with community goals and breaches of social or environmental laws bring penalties and sanctions to corporations which diminishes shareholder's revenues.

These instances tend to show that shareholders and the firm are in effect benefited by responding to the interests of the firm's stakeholders. A company which gives due attention and response to its stakeholder's interests will build credibility and confidence in the market which in turn improves acceptance of its products and services. So, it becomes necessary for Ethiopia to adopt some components from both models of corporate governance. There is no a model that is purely shareholder or stakeholder in the world. In addition to this, both models have their own problems and advantages. It is then advisable to take the best out of each model and apply it taking in to account the specific economic and corporate environment of the country.

We should stop thinking in a "shareholder or stakeholder" mindset as if they have incompatible interests and start looking at the issue in a "shareholder and stakeholder" way. Shareholders should be seen as one of the stakeholder of a given company among the various other stakeholder groups. As each stakeholder group has its own interest which is at times conflicting with the other, a prioritization and compromise of interests should be made by the corporate governance.

In conclusion, out of the two models of corporate governance, Ethiopia's choice should be the one described as the third approach i.e. "enlightened shareholder value" approach. This is preferable as it takes into account both models. The upcoming amendment to the Commercial Code should provide that managers and boards should take in to account the interests of other stakeholder groups when they make decisions at the same time without putting the interests of the shareholders at risk. So, the following points should be considered by our policy makers and legislators:

- Any system of corporate governance has specific cultural, economic and political condition on which it is based. So, as far as the structure of corporate governance is concerned, Ethiopia should look for some experiences in both models which fit her own circumstances.
- As far as firm purpose is concerned, both the shareholder and stakeholder models of corporate governance have their own drawbacks. The best option for Ethiopia would be to take a middle position between the two models in balancing the interests of the shareholders and the stakeholders. In this regard, the "enlightened shareholder value" approach which is introduced by England in 2006 should be taken as a third way and adopted in Ethiopia as the principle takes in to account the interests of both shareholders and stakeholders.
- As far as board structure is concerned, Ethiopia should continue with the unitary board structure for two reasons. Firstly, separating supervision and management into two independent organs and involving outside stakeholders in the supervisory board has its own reasons specific to the country's cultural, historical and economic conditions. We don't find that type of condition in Ethiopia that makes the two-tier board structure a must. Secondly, the purpose that can be achieved by adopting a two-tier board can also be met by a unitary board since management and control functions can also be separated in the unitary board structure.
- The existing Commercial Code of Ethiopia doesn't take into account the interests of stakeholders of a company. So, the upcoming amendment to the commercial code should contain some provisions which ensure that the interests of stakeholders are considered and balanced by the board and the management.
- To this effect, the amendment to the Commercial Code should include some principles which oblige board of directors and managers of companies in Ethiopia in that they must act in a manner that considers:
  - the likely consequences of any decision in the long term,
  - the interests of the company's employees,
  - the need to foster the company's business relationships with suppliers, customers and others,
  - the impact of the company's operations on the community and the environment,

- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of the company.

- ➢ Any code of corporate governance in Ethiopia, be it voluntary or mandatory, should provide some rules that should be followed by directors and managers when making decisions that affects the various stakeholders. The code should impose some positive obligation on the company management to consider and deal with the interests of stakeholders of the company in addition to the shareholders.
- ➢ Employees are one of the main stakeholders to whom the success of a company is largely attributed. Despite this, the Commercial Code and the various directives do not allow/ and sometimes prohibit the inclusion of employees in the board of directors. These laws should be revisited to allow board membership of employees so that their concerns are heard and interests considered.
- ➢ The National Bank Directive on Licensing and Supervision of Banking Business Bank Corporate Governance No. SBB/62/2015 Article 2 (2.3), in defining corporate governance, states that the ultimate objective of corporate governance is realizing long term shareholders' value and other stakeholders' interests. This definition, which seemingly implies the "enlightened shareholder value" approach, signifies the need to focus on the rather long term shareholder value by giving due attention to the stakeholders as well. So, it becomes necessary to put in the upcoming Commercial Code, in the directives, codes of corporate governance and other laws provisions which try to achieve the realization of those objective stated in the definition.

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