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   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

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   HYPOTHESES

   RESEARCH METHODOLOGY

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   RECOMMENDATIONS/SUGGESTIONS

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   APPENDIX/ANNEXURE

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CONTRIBUTIONS TO BOOKS

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

JOURNAL AND OTHER ARTICLES

- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

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- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

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THE ROLES AND CHALLENGES OF SHARE COMPANIES IN ETHIOPIA

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ABSRTACT

It is known that shortage of capital is one of the factors that discourage investment in the Ethiopian economy. Share companies deliver best remedy for this problem because they can organize limitless people with small shares so that they form huge capital. Despite their potential role, Share companies are facing various challenges; due to the adverse corporate environment existing in Ethiopia. Hence, the study were conducted to explore the potential roles of share companies that can be contributed to development endeavors and identify the challenges facing them that limit their ability to achieve their roles as a result of existing Financial system. To be able to gather the necessary data, the study utilizes the descriptive analysis. Herein, the respondents were randomly selected from publicly held share companies. The questionnaire was the research instruments used for the data-gathering. The output of the study shows that although Share companies play important and crucial role in development endeavors; they are facing serious challenges. Share companies in Ethiopia are not furnished with comprehensive legislative framework and an organized as well as orderly operating environment; which could help establishment of several share companies that would accelerate the development endeavors and to the share buying public, it would enhance confidence in the industry.

KEYWORDS

Capital Mobilization, Investment Intermediaries, Regulation, Roles of Share Companies and Secondary market.

INTRODUCTION

A share company is a company whose capital is fixed in advance and divided in to shares Commercial Code of Ethiopia (1960). The word corporation and share companies are one and the same. Corporation is created (incorporated) by a group of shareholders who have ownership of the corporation, represented by their holding of common stock. The history of the establishment of share companies dates back to the end of 1880s in Ethiopia. The establishment of share companies in those periods was by an imperial charter because there was no law accommodating their existence. The same thing was repeated in Ethiopia when the Emperor's blessing was required. Then it was in Emperor Haile Sellasie's period i.e. in 1960 the first commercial code was legislated and the establishment of Share Company recognized for the first time. And right after the Derg had assumed power in 1967 E.C., the system of constituting share companies was discarded to oblivion for a period of 17 years. After the downfall of Derge Regime, due to liberalization of investment policy, beginning in the early 1990s, several initiatives have been taken that resulted in a series formation of commercial bank and insurance firms. Following the financial institutions different share companies in different sector had been established. There are now many initial offerings of shares to the public. (The Ethiopian Herald: 2009)

Establishment of share companies in Ethiopia shows faster growth in past two years. Establishing companies by raising capital through public equities has been in the boom in Ethiopia's business milieu, especially since mid 2008. Though the trend has been there for more than a decade after the first private banks started to popup through the same mechanism of raising capital, never have public equity offers been as many as the past one year (Nassissie Girma)

LITERATURE REVIEW

It is widely accepted that corporations have economic, legal and even social roles. According to Crane, Matten and Moon (2008) Corporations mobilize savings for investment**.** When people draw their savings and invest in shares, it leads to a more rational allocation of resources because funds, which could have been consumed, or kept in idle deposits with banks, are mobilized and redirected to promote business activity with benefits for several economic sectors such as agriculture, commerce and industry, resulting in stronger economic growth and higher productivity levels of firms. In modern times, corporations have become an increasingly dominant part of economic life. According to Helena Monteiro (2006) People rely on corporations for employment, for their goods and services, for the value of the pensions, for economic growth and social development. In addition, corporations can contribute with a vast array of resources that include: technology, human resources, technical expertise for capacity building. According to Gary Quinlivan (2000) the economic role of corporations is simply to channel physical and financial capital to countries with capital shortages. As a consequence, wealth is created, which yields new jobs directly and through "crowding-in" effects. In addition, new tax revenues arise from corporation generated income, allowing developing countries to improve their infrastructures and to strengthen their human capital. By improving the efficiency of capital flows, corporations reduce world poverty levels and provide a positive externality.

Investments in a business form of share companies can offer special benefits that other form of business may not deliver in development endeavor. Share companies have unique characteristics which distinguish them from other forms of business, thus share companies as a result of their unique nature, and have more (wider and deeper) potential to contribute for development endeavor of a country. Haskin (1997) states corporations are subjected to double taxation. The tax law of Ethiopia (Income Tax Proclamation No.286/2002) legislates that share companies must pay 30% of flat rate in the form of business profit tax and 10 % dividend tax.. Double taxation contributes to enhancement of government revenue because it privileges the government to collect tax twice. Share companies also have a potential to enhance governments revenue by offering an opportunity for capital gain tax. According to Larsen and Pyle () it is possible for corporations to assemble large amount of capital from the combined investment of many stock holders. In business milieu it is usually uncommon to find peoples outfitted with all skills and resources (entrepreneurial skill, technical know-how and financial resources). Share companies provide a best remedy by combining resource of different peoples and putting it together. Hence, share companies can mobilize large number of domestic resources. By pooling resources from large number of investors share companies can realize massive investments which may not be possible to be established by single individuals. Only few individuals may have the financial ability to establish such massive investments. However, by pooling the resource of many individuals through public offering of shares, share companies generate gigantic capital necessary to make massive investments (McNair and et al:2003).

According to Commercial Code of Ethiopia (1960) Share Company can issue a share at a minimum price of birr 10. Thus, both small and wealthy individuals can invest according to their financial capacity. Besides, investors need not be reside in the jurisdiction of the company's location. Theoretically they are assumed to be accessed in every corner of the country. Hence, share companies have great potential to provide investment opportunity to the public. The maximum number of share holders in a company is not limited. Thus, share companies can be owned by millions, thousands, and hundreds of share holders. Since all the risks and incomes are distributed over the owners and shares are freely transferable form one to another share companies have a potential to redistribute the income and risks (Meigs and et al::2001). Share companies are likely to have strong financial capability. Hence, they are likely to acquire the most up-to-date technology and know-how. Corporations are able to develop and market expensive new technologies more effectively than individuals operating other form of business (McNair and et al: 2003). Besides share company are likely to establish research and development departments which work on improvement and modernization of products and services provided by the company. In addition Share companies offer an opportunity to entrepreneurs who have project idea, but limited resource to implement the idea by using other people's money or technical know-how.

IMPORTANCE OF THE STUDY

The study is important from many perspectives which could be summarized as follows: It can help in improving the existing literature on share companies; it can improve the awareness among the public about role of share companies; it can help in indicating the main problems and possible solutions to policy makers. It can serve as a basis for further study.

STATEMENT OF THE PROBLEM

Investments in a business form of share companies can offer special benefits that other form of business may not deliver in development endeavor. Countries like Ethiopia with very small domestic product are expected to exploit the opportunity of creating a share holding company and enjoy its benefit. In recent time there are many people with project ideas offering shares to the public. But the buying public is hesitant to submit. New companies which wish to raise capital by public offering must float the share for a long period of time. Moreover, the companies end up undersubscribed. Shareholders owning shares with the various share companies find buyers privately, to sell off their shares (Addis Fortune). Though the business of initial public offering by the financial sector is heavily regulated by the Central Bank, this is not the case with the numbers of initiatives in other sectors. The share buying public is preposterously left to the mercy of the promoters. Hence, the study were conducted in order to describe the potential roles that can be played by share companies and assess the challenges post by the unfavourable corporate environment in Ethiopia.

OBJECTIVES

The general objective of the study is to explore the potential roles of share companies that can be contributed towards development endeavors and identify the main challenges being faced by these companies that are acting as limiting factor in order to achieve their role.

The specific objective of the study includes:

- To explore the potential roles of share companies.
- To know the basic characteristics of share companies during initial public offerings.
- To describe the prevailing corporate environment.
- To identify the main challenges being faced by the share companies.

RESEARCH METHODOLOGY

To be able to gather the necessary data, the study utilizes the descriptive analysis. In terms of approach, the study employed both qualitative and quantitative approaches. The quantitative approach focused on obtaining numerical findings and the qualitative approach focused on personal observations, description and individual insights of the respondents. To collect the necessary information, the study uses both the primary and the secondary data. The primary data are derived from the answers respondents gave in the questionnaire and interview. The secondary data on the other hand, are derived from the findings stated in published and unpublished documents. Herein, 20 respondents were randomly selected from publicly held share companies. The representatives of the company who were chosen in this study accomplish a questionnaire and interviews to assess challenges being faced by of share companies in Ethiopia. The result of the survey was processed by SPSS.

RESULT AND DISCUSSION

Though the concept of corporate environment may be too broad the study investigates the corporate environment in terms of: public offering environment, regulatory environment, transferability environment, and financial intermediaries' environment.

CHARACTERISTICS OF SHARE COMPANIES DURING PUBLIC OFFERINGS

The study in this section investigates the characteristics of initial public offerings at a time of establishment: the subscription rate, the share floatation period, number of share holders and the affordability of minimum investments set by companies.

DESCRIPTIVE STATISTICS

	N	Minimum	Maximum	Mean	Std. Deviation
Subscription rate in Percent	20	25%	84%	52.75%	14.63189
Minimum investment Requirement in Birr	20	400.	50000.	17,220	12108.26599
Length of floatation period in Month	20	10	24	15.5	4.19900
Number of share holders	20	131	15,000	3039.8	4127.10938
Valid N (list wise)	20				

Source: survey data (2011)

The experience of share companies in Ethiopia in mobilization of capital shows almost all companies are undersubscribed. The subscription rate of companies ranges from 25% to 84 % with a mean of 52.75%. Collectively companies are under subscribed by 47.25 %. The time required to sale shares in Ethiopia is 10 to 24 months .The mean (average) share flotation period is 15.5 months. Respondent's perception on lengthy of time it takes to float new shares indicates that 5 % perceive the period is short, 30 % medium, and 65 % long. The minimum investment requirement set by companies' ranges from 400 Birr to 50,000 Birr with a mean of 17,220 Birr. Majority of respondents (85%) perceive that the minimum investment requirement set by most share companies is unaffordable by small investors. The number of share holder in a company ranges from 131 to 15,000 with a mean of 3,039. Even though there is no standard to say the number of share holders in a company is few or high they can distribute the risk and income to more share holders than are now.

THE REGULATORY ENVIRONMENT

Share companies as a result of their unique nature needs special regulations. In Ethiopia Share companies are regulated by Ministry of Trade and Industry in general. Specifically share companies in a business of financial sector (insurance companies and banks) are regulated by National Bank of Ethiopia. Respondents indicates that financial sector share companies are subjected to high regulations relative to non financial sector share companies which are almost less regulated. The provision for non financial sector share companies is below sufficient and the monitoring and supervision by regulatory boy is far below the required level for non financial sector share companies. Friedman and Grose (2006) states that Issuers and investors will have more confidence in raising and investing funds in the equity market when the legal, regulatory and supervisory framework promotes new issues and, at the same time, provides adequate mechanisms for protecting investors. Mariassunta Giannetti (2004) revealed that the demand for equity is affected by investors' protection. Investors claim that they decrease their holdings or even avoid investing in companies or countries that are perceived to provide poor investor protection. Regardless of this fact there is poor regulation of securities in Ethiopia.

THE FINANCIAL INTERMEDIARIES ENVIRONMENT

Investopedia says financial intermediaries are institutions which act as the middlemen between the investor and the firms raising funds. Financial intermediaries play important role in process of raising funds by share companies. In fact, share companies may directly interact with investors without the service of financial intermediaries; however, the possibility of raising fund successfully is in doubt. Financial intermediary emerged because of inefficiencies found in direct interaction between the investors and the issuing companies (Kidwell and Peterson: 1990). Thus, share companies directly interacting with investors indicate inefficiencies in rising of funds. In the study 90 % of share companies sell their shares directly to investors while the remaining through brokers. Most companies are selling their shares directly to the public. They are not availing the service of intermediaries in selling of their shares. Though they play important role in selling of new shares by finding buyers, the service of capital market intermediaries such as investment bankers and brokers are limited in Ethiopian corporate sector, which results in inefficiency of share companies to distribute and market shares. This fact can be strengthening by looking in to place of sells for shares. The practice of share companies in selling of shares in terms of location indicates that 60% of companies offer (sell) their shares only at Addis Ababa, 35 % offer (sell) their share in Addis Ababa and some other major cities. Only 5% of the respondent indicates that they sell their share in remote areas. Most companies are not accessible in remote areas.

Share companies usually offer their shares for subscription to different types of investors either directly to individual investors or indirectly to institutional investors or to both. It is recognized that institutional investors have a great potential to mobilize large amount of saving from large number of individuals for investment. 100% of respondents reveal that individual investors are dominant in holding of shares, and institutional investors (excluding mutual funds) are involved to some extent. Though it is recognized that institutional investors have a great potential to mobilize large amount of saving from large number of individuals for investment, institutional investors in Ethiopia are not mobilizing adequate amount of capital from the public. This fact can be discovered by looking in to subscription rate of share companies in Ethiopia in which companies are undersubscribed on average by 47 %. The institutional investors involved in mobilization of capital in Ethiopian corporate sector are lacking of mutual funds; which have a great potential to mobilize large amount of savings from large number of individuals by offering a variety of investment schemes with different investment goals and by specifying low amount as minimum investment.

THE TRANSFERABILITY ENVIRONMENT

Since organized exchange (stock exchange) is lacking in Ethiopian corporate sector, shares transfer are facilitated in disorganized manner. In the disorganized manner transferability of shares are facilitate by each company's head office through the share administrator or the share holder find privately buyers. The study in this section investigates the transferability environment of shares in terms of liquidity, transaction cost, and fairness of price determination during transfer. Liquidity of shares means simply the convenience and speed of transferring shares in to cash or transferring shares from one person in to another. 53 % of respondents believe that shares are less liquid, while 42 % agree they are moderately liquid. Respondents indicate that it usually takes 1 week to 6 months to find buyers and transfer the share. With respective to transaction cost 63 % of respondent believe that share transfer involves high transaction cost, while 32 % believe shares transfers involve moderate cost. In a line with this, respondents indicate share transfer which is facilitated by external body incur on average 10% charges of the par value. With respective to fairness of price determination 84% of respondent believe that share transfer involves unfair price determination, and the remaining 16 % of respondents indicate share transfer involves faire price determination. In a line with this, respondents indicate that 68 % share transfers were priced at the same price to the par value, and the remaining 32 % above the par value. In Ethiopian corporate sector shares are priced unfairly in which the price of shares do not consider the actual demand and supply of shares and the earning and growth potential of the company .

FINDINGS

Share companies in Ethiopia are facing multiple challenges that test their ability to achieve their potential roles which emanate from different causes. Share companies have a potential to enhance the governments revenue by providing an opportunity for capital gain tax. However, as most shares are transferred at the same price in which it was bought (the par value) the potential of share companies to provide an opportunity for capital gain tax is limited. Share companies have a potential to mobilize domestic resource by combining and putting together different resources for investment (entrepreneurial skill, technical know-how and financial resources). However, the public is hesitant to subscribe for initial public offerings. Hesitation of the public to offer their resource diminish the potential of share companies to foster innovation and technological adaptation as fostering innovation and adapting technology is explained by strong financial capacity of share companies. Besides, hesitations of the public also diminish the potential of share companies to promote entrepreneurial societies as entrepreneurs may be discouraged by low response of the public. Although share companies have great potential to establish big business, they are not utilizing to the maximum of their potential; they are undersubscribed. Share companies have a potential to provide investment opportunity to both the small investors and wealthy inventors. However, there is little opportunity to small investors as the minimum investment requirement set by share companies is beyond the financial capability of small investors. Besides, most shares offering are restricted to the capital city and some major cities in the country.

Share Company has a potential to distribute income and risk over large number of individuals as long as large number of individuals subscribe. Besides, share companies also have a potential to redistribute the risk and income over large number of individuals by allowing freely transferability of shares form one individual to others after the first issue. But, there is low liquidity of shares in Ethiopian corporate sector. Though share companies can provide an opportunity to institutional investors to improve their value this potential is diminished partially by poor transferability of share prevailing in Ethiopian corporate sector.

The study from the above investigations infers that the corporate sector in Ethiopia is threatened by multiple challenges which diminish its potential roles to contribute for development endeavors. The key challenges of share companies which diminish its potential role are identified and scrutinize as follows.

I. ***Poor regulatory environment;*** though, not the case with financial sectors, corporate sector in Ethiopia is characterized by poor regulatory environment. In a poor corporate regulatory environment share holders have no guarantee that corporate issuers may sell bad securities to the public. Besides they have no guarantee that their interest and rights will be safeguarded. In an environment where share holders are not protected, it is known that they become hesitant to subscribe.

II. ***Poor transferability of shares;*** transferability environment in Ethiopia is characterized by less liquidity, high transaction cost, and unfair price determination. Thus, the existing share holders are suffering transferring of shares. They have limited option to switch investment in one company and invest the same in other company which they believe is profitable or meet their investment objective. When investors need the cash for any reason it is at delayed time that the share will be converted. The soreness prevailing in the existing share holders put up multiple challenges to share companies.

III. ***Inefficient marketing of share;*** In finding buyers of new issues the service of financial intermediaries are not availing. The process of finding buyers by the company is not usually efficient since; companies which offer shares to the public may not be well familiar with the market behavior as they are not constantly in the business of finding buyers and usually have no already established network to distribute shares.

IV. ***Inefficient capital mobilization;*** Share companies are not well achieving in mobilizing adequate capital required for investment as all share companies are undersubscribed. Share companies used to mobilize the capital largely from individual investors. Though institutional investors are participating in mobilizing of capital, the result is not as required since they are not providing adequate capital required by share companies. Mutual funds are missing in the capital mobilization environment though they have a potential to mobilize large amount of capital from large number of individuals (both small and wealthy investors) by providing a varieties of investment opportunities.

SUGGESTIONS

The study recommends the following points to overcome the challenging corporate environment and bring on a possibility of exploiting to the most of the potential of share companies.

1. Share companies need to be furnished with a comprehensive legislative framework to enhance confidence in the industry. The corporate law needs to be revised so as to ensure fair dealing and provide protection to investors. It would be better if separate regulatory body is established to regulate and promote the corporate sector.
2. Important financial intermediaries such as Mutual Funds and Investment Bankers need to be promoted to facilitate and prop up rising of funds by share companies.
3. The share transferability environment need to be provided with an organized as well as orderly operating environment to make the business of buying and selling shares easier, profitable and predictable.

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APPENDIX

QUESTIONNAIRE

1) Following are questions regarding to general information of the company, please fill in the blank space.
a) Business purpose of the company: ______________________________
b) Period of time for which the company is established: _________________
2) The following are questions relating to initial public offering of shares when the company was established. Please give the figure, word or sentence
a) Total number of shares (capital) offered to the public; ______________________
b) Total number of shares (capital) subscribed by the public: __________________
c) Par value/price per share: ____________________________
d) Minimum amount of Investment: ___________________
e) Service charge/premium per share: _________________________
f) The opening date for sale of shares: ________________________
g) Closing date for sale of shares: ___________________
h) Total number of share holders____________________________
i) Place of sales for shares;
i) Only in Addis Ababa
ii) In Addis Ababa and some other major cities
iii) In remote areas
3) How do you feel the response of general public towards initial public offerings?
a) Are hesitant to subscribe
b) Eager to subscribe
4) How was the shares marketed to the public?
a) Through brokers
b) Through the company agents
c) Through investment bankers
d) The company head office
e) Please specify if other way were employed________________________________
5) The following are questions relating to shareholding profile of your company, please indicate the availability.
A shares held by foreigners
b shares jointly held by individuals
c Shares held by institutional investors (Banks, Insurance, Pension Funds, Unions Cooperatives etc...) except Mutual funds
d Shares held by Mutual funds
6) The following are question in relation to transfer of shares from one to another, please provide brief description for each items.
a) How shareholders find buyers when they need to sell their share ____
b) What costs do shareholders incur while transferring shares ____
c) What is the average time consumed to sell shares ____
d) What is the average price realized on sells
i) Above the par value
ii) Below the par value

iii) Equals to the par value

8) How do you perceive the sufficiency of corporate law to disclose information, and ensure transparency?

a) High b) Moderate c) Low

9) How do you see the degree of regulation to share companies?

a) High b) moderate c) low

10) How do you perceive the monitoring and supervision by corporate regulatory body?

a) High b) moderate c) low

11) How do you perceive the capacity and readiness of share company regulators to enforcement of compliance?

a) High b) moderate c) low

12) How do you perceive the length of time it takes to float new shares in Ethiopia?

a) Long b) moderate c) low

13) How do you perceive the liquidity of shares?

a) High b) moderate c) low

14) How do you perceive the Affordability of share price by the small investors?

a) High b) moderate c) low

15) How do you perceive the Fairness of price determination while buy/sell of shares?

a) High b) moderate c) low

16) How do you perceive the Transaction cost incurred when buying/selling of shares:

a) High b) moderate c) low

17) What do you think are the major challenges to corporate sector in Ethiopia? Please explain.

____

18) What do you suggest to overcome those challenges and bring on favorable corporate environment in Ethiopia?

____

19) Please put your general comments about role and challenges of share companies in Ethiopia.

____

RESPONSE ON INITIAL PUBLIC OFFERINGS OF COMPANIES

	Capital offered to the public in Million	Capital subscribed by the public in Million	Price per share in Birr	Minimum investment requirement	Service charge in Percentage	Time consumed to float shares in months	Number of share holders
A	50	42	500	50,000	20	NA	800
B	100	40	500	NA	5	12	NA
C	100	50	1000	25,000	5	24	1000
D	300	200	100	400	3	22	7002
E	50	25	25	25,000	NA	NA	131
F	66	17	25	25,000	NA	NA	300
G	200	85.1	1000	25,000	5	19	540
H	600	280	1000	5000	6	11	15,000
I	432	199	25	25,000	20	12	6400
J	300	149.5	1000	25,000	5	10	2778
K	60	24	1000	5000	9	NA	3800
L	93	55	1000	10,000	10	NA	220
M	279	160	1000	4000	5	24	6000
N	50	30	5000	25,000	10	13	NA
O	80	25	1000	20,000	7	16	750
P	50	24.2	1000	20,000	20	NA	486
Q	15	10	1000	NA	6	12	150
R	50	40	500	NA	NA	NA	554
S	306	160	100	5000	3	NA	11,200
T	335	208	100	10,000	10.5	NA	335

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With sincere regards

Thanking you profoundly

Academically yours

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