

Legal Aspect of the Development of Stock Exchange in Ethiopia

Dagnachew Worku Gashu
Lecture of Law, School of law, Arba Minch University, Ethiopia

Abstract

An organized stock exchange mandatorily requires the existence of a law that recognizes the market as an entity, regulate the issuance of securities, the subsequent transactions of securities, rules of listing, rules regulating disclosure of information, rules regulating axillaries like stock brokers, rules regulating insider trading, rules establishing and authorizing supervisory authority, and rules for settlement of disputes arising out of securities transaction. This article examines the legal aspect of the development of an organized stock exchange in Ethiopia from a historical perspective. It finds out that there has not been any sufficient legislative framework for regulating stock exchange in the country though there were signs of an organized stoke exchange in the 1960s.

Keywords: Stock exchange, Legal aspect, Development.

1. General overview on the Concept and Significance of stock exchange

1.1. Concept of stock exchange

Although the prefixes stock signifies a share of corporations, the phrase stock exchange is commonly used to portray not only the place where shares are exchanged but also other securities like company and government bonds. Regarding this the definition given by Black's Law Dictionary on security exchange is instructive. It is defined as "[a] marketplace or facility for the organized purchase and sale of securities, esp. stocks" or as "[a] group of people who organize themselves to create such a marketplace and which is often shortened as stock exchange."¹ From this description two points worth critical consideration. Firstly, it is not any marketplace or group of persons who create such market place which is merely termed as a securities exchange but it is the element of organization of the people or the market that is the main yardstick. This element precludes every unorganized or informal security exchange from the ambit of the definition. The second important point is that the definition endorses security exchanges are often shortened as stock exchange and the main constituents of the market are stocks or shares. Hence, underpinned by this description, I will primarily deal with the development of the law in relation to stock exchange in Ethiopia as a place where securities of companies and government is traded. Stock exchange implies the specified place and formal organization of members (actors) of financial assets in which among others stocks and debt securities are bought and sold.²

It is customary to divide stock markets into primary and secondary. Primary stock markets refers the place where selling of new securities for the first time takes place via a mechanism called underwriting so as to finance real investments.³ However, the original buyers of securities may want to resale them for various reasons. In such scenarios, secondary stock market plays an important role. Such markets are either organized or over the counter ones.⁴ Organized secondary stock markets are places of exchanges of securities that meet the listing conditions.⁵ Conversely, over the counter stock exchange is a market avenue for the selling and buying of securities of usually small companies and others which do not meet the listing conditions.⁶

1.2. Significance of stock exchange

It is asserted that the existence of an organized stock exchange is important for the economic progress of developing counties, like Ethiopia. It is viewed as a means of channeling money from those who don't have an immediate productive use to those who do.⁷ In particular, security exchange (stock exchange) is significant for the economy in the following ways:⁸

- ✓ For effectively raising capital for commercial purpose and opening an investment opportunity for individuals and institutions.
- ✓ Mobilizes domestic saving as it creates additional investment portfolio options.
- ✓ It contributes an important role for liquidity of capital investment.

¹A. Garner (ed.), Black's Law Dictionary, (8th ed., 2004), p. 4225.

²Ahferom Teklay, Should Ethiopia Consider Establishing Of A Stock Exchange? (Unpublished thesis, 2011), p. 10 & 11.

³Araya Debessay and Tadewos Harege-work, Towards the Development of Capital Market in Ethiopia, P 227.

⁴Ibid.

⁵Ibid.

⁶Ibid.

⁷R. Ruecker, Market Potential Assessment and Road Map Development for the Establishment of Capital Market in Ethiopia (2011), p. 9.

⁸Tikikile Kumulachew, Regulation of Initial Public Offering of Shares in Ethiopia: Critical Issues and Challenges (2011, unpublished thesis), p. 60-63.

- ✓ Enhances corporate governance since it creates an easy forum for discontented security holder to sell her security which in turn puts a pressure on the management of companies to improve their governance so as to preserve their fame as well as to avoid any hostile takeover.

2. The legal aspect of the development of stock exchange in Ethiopia

An organized stock exchange should have an elaborate legislation and regulatory organ in order to protect investors of securities from among others frauds, misrepresentations, collusion between brokers, insider trading, and selective disclosure of information.¹ The legal aspect of the development of stock exchange must be examined in light of the presence of laws which prescribe the issuing of new securities, rules for listing of securities, govern credit rating agencies, regulate the market behavior of auxiliaries (like stock brokers), rules of adequate disclosure and transparency of information regarding a given security, effective and immediate dispute settlement avenues, and law that authorizes a supervisory organ that supervise the proper running of the stock exchange. In Ethiopia there is no particular securities law which is enacted to regulate and address these issues.² In addition to this, it is very clear that legal regimes governing public offering of corporate securities are inextricable from the process of share company formation and operation³ since it is this form of business organization that is authorized to issue transferable corporate securities. The legal regimes governing share companies are the commercial code of Ethiopia, civil code of Ethiopia, banking business proclamation, insurance business proclamation, Micro finance business proclamations, Business licensing and Registration Proclamation, and other specific government institutions which issue license under their specific jurisdictions.⁴ An attempt to examine the development of the legal aspect of stock exchange in Ethiopia requires to go through the analysis of these laws on whether they have rules on the issuance of securities, rules that govern the behavior of auxiliaries, rules that proscribe insider trading, rules that mandatorily require disclosure of information, rules regarding listing of securities, rules establishing and governing credit rating agencies, rules on the establishment of stock exchange as an entity, rules that provide the establishment and power of the security regulatory authority, and rules on the settlement of disputes arising out of stock market. Here I attempt to discuss the legal development of stock exchange in Ethiopia by examining the relevant laws and the practice across the Imperial period, the Derg period and the current trend.

2.1. The Legal Development of Stock Exchange During the Imperial Period

During the Imperial period there were signs for the establishment of a stock exchange. Commencing from the issuance of the first share for public subscription in 1956 by a company called Ethiopian Abattoirs, share exchange was carried out through the facilitation of the then state bank of Ethiopia.⁵ However, the dealing was short of to be an organized stock exchange as it was carried out through the modality of over-the counter stock markets.⁶ What I mean is that there was no specific law which is instrumental for such operation to be considered and elevated as a formal and organized legal entity to deal with stock exchange.

Because of the growth of the economy and the increment of the number of share companies, by the 1965 an alternative institutional scheme was devised to facilitate and self-regulate the operation of the security market known as the Share Dealing Group.⁷ The group was consisted of six institutions which were the National Bank of Ethiopia, Addis Ababa Bank, the Commercial Bank of Ethiopia, the Development Bank of Ethiopia, the Investment Bank of Ethiopia, Sabean Utility Corporation, and a certain individual named Mr. Alfred Abel.⁸ Though it can be said it was a good beginning towards an organized stock exchange, it cannot be asserted here that there was an organized stock exchange in the absence of a legislation that conferred the establishment of a stock exchange with its own regulatory authorities, rules for listing of stocks, sufficient rules that govern the behavior of the auxiliaries, and soon.

One may argue that the Commercial Code which came into life in 1960 might had been the legislative base for the activities which were carried out during the Imperial period towards the establishment of an organized stock exchange in Ethiopia. Of course, there are provisions which are indicative of the establishment of stock exchange. Such provisions provide the form of shares, rights and duties of shareholders, class of shares, transactions on shares, and soon.⁹ Particularly, Articles 332, 333, 340 and 341 of the commercial code provides the transfer of share form one shareholder to another. Regarding auxiliaries that facilitate the operation of stock

¹ Araya Debessay and TadevosHarege-work, cited above at note 3, p. 230.

² TikikileKumulachew, cited above at note 8, p. 65.

³ Ibid.

⁴ TikikileKumulachew, cited above at note 8, p. 65

⁵ Araya Debessay and TadevosHarege-work, cited above at note 3, p. 231.

⁶ Ibid.

⁷ Ibid.

⁸ Ibid.

⁹ Commercial code of Ethiopia, Arts. 304, 325-346

exchange through bring the buyer and the seller of securities it can be inferred that the provisions of the commercial code under title II that governs auxiliaries and agent of traders can be called and applied.¹

In connection with share companies the commercial code has authorized the issuance of debentures which can be transferable (marketed) form one individual to another.² Though one can't find the definition of a debenture directly from the code, it can be collected from the reading of different provisions to mean a certificate which ascertains a debt owed by the issuing company to its holder with the duty to pay interest and payback the main debt or convert to share.³

On top of these, there is a provision in the commercial code that directly mentioned the clause 'stock exchange' and quoting shares in the stock exchange which I prefer to write it here:

Art. 463. - Right of withdrawal from the company.

(1) Shareholders who dissent from resolutions concerning any change in the objects or nature of the company or the transfer of the head office abroad may withdraw from the company and have their shares redeemed, at the average price on the *stock exchange* (emphasis mine) over the last six months. Where the shares are not *quoted on the stock exchange* (emphasis mine), they shall be redeemed at a price proportionate to the company's assets as shown in the balance sheet for the last financial year.

This provision entitles the right to withdrawal from the company for a dissenting shareholder in the event of change of the nature or object or the transfer of the head office of the company out of Ethiopia. Such shareholder is entitled to reap the average price of his shares available in the stock market over the prior six month provided that the share of the company is quoted on the stock exchange. From this provision of the commercial code, it is evident to assert that there was an expectation in the mind of the law maker regarding the establishment of a stock exchange as well as a rule for quoting (listing) of shares in the stock exchange.

However, a critical review of these relevant parts of the code assures that the provisions are rather insufficient indications for the establishment of a stock exchange than an adequate law that provide the rules of the game for the establishment of the exchange. If I repeat myself a developed and proper stock exchange has a law in its back that prescribe the recognition of the stock exchange as an entity, rules on issuing of new securities, rules for listing of securities, govern credit rating agencies, regulate the market behavior of auxiliaries (like stock brokers), rules of adequate disclosure and transparency of information regarding a given security, effective and immediate dispute settlement avenues, and law that authorizes a supervisory organ that supervise the proper running of the stock exchange. Seen from the vantage of these basics of an organized stock exchange, one can deduce that the above cited and examined provisions of the commercial code are too rudimentary to be sufficient.

The establishment of a stock exchange in the Ethiopian business landscape is also indicated in the government bonds proclamations enacted during the time of the Imperial period. If I launch my emphasis on proclamation number 172/1961, it authorizes the issuing of government bonds with the respective par value, interest rate as well as maturity date.⁴ In the preamble of this proclamation it is succinctly pointed out that issuance of a bond is a way for starting one organized capital market in the country. According to this it clear that issuing of Treasury bill was understood as one important facility for establishment of a capital market in the then regime. Apart from this, establishing one capital market by giving the necessary security to mobilize money and capital was earmarked in the preamble of the proclamation. However, there is no such law enacted for the organization of capital market during that time except for the enactment of regulations as well as subsequent proclamations merely dealing with issuance of government bonds.⁵

2.2. The Legal Development of Stock Exchange During the Derg Period

This regime is well known for its nationalization and transfer in to government ownership of financial institutions and large companies in 1975.⁶ With this event, the Share Dealing Group formed in 1965 came to an end as well as highly dysfunction the commercial code. Hence, one can say that the Derg regime has militated against the promising institutional and legal development towards an organized stock exchange in Ethiopia. It is not over speculation to assert that if this share dealing group continued its task practically, a supporting legal instrument for formal stock exchange would have been materialized. Hence, the Derg regime was really a hindrance for the legal development of organized stock exchange in Ethiopia.

¹ Especially, see Id. Arts. 56-62.

² Id. Arts. 429 cum 434.

³ See for Example, Id. Art. 433.

⁴ Government Treasury Bill (Bond) Proclamation, 1961, Art. 3, Proc. No. 172, *Nega Gaz.*, Year 5, No 11.

⁵ See for example, The Premium Bonds Regulations Legal Notice No. 274/1963 and Legal Notice No. 334/1968, Savings Bonds Regulations Legal Notice No. 275/1963; Legal Notice No. 294/1964; Legal Notice No. 342/1968 and Legal Notice No. 368/1969, The Treasury Bills Proclamation No. 263/1969, The Special Authority of the Minister of Finance to Contract Loans and Guarantees Proclamation No. 247/1967.

⁶ Araya Debessay and Tadewos Harege-work, cited above at note 3, p. 232.

2.3. The Legal Development of Stock Exchange Under The Current Government

In the current Ethiopian People's Revolutionary Democratic Front (EPRDF) incumbency of Ethiopia, one can't find a law which prescribes the rules for the establishment of an organized stock exchange. One thing that must be mentioned at this moment is that the commercial code of the country which has some rudimentary rules in relation to stock market has revived with the coming into power of this regime. However, as I have pondered on it repeatedly, the code doesn't have sufficient rules for the effective running of the complex market of stock exchange. Indeed, the commercial code is not the only law which govern the overall affair of transferable security issuing business organization i.e. share company in the land of Ethiopia. There were/are specific proclamations which amended/amend the code and govern a share company in relation to business registration and licensing¹. There are also proclamation No. 592/2000 that amended some rules of the commercial code in relation to banking sector share companies, proclamation No. 746/2012 in relation to insurance business share companies and proclamation No. 626/2009 in relation to micro finance business companies. If I examine the banking business proclamation as a representative example, compared to the rules in the commercial code it came up with stringent rules regarding forms of shares as it authorized to issue only registered ordinary shares unlike that of the commercial code in which both bearer and preference share are allowed, transfer of shares to be registered as well as stringent cap for the maximum amount of shares an individual shareholder can hold which is 2% of the subscribed capital of the company.² These rules of the proclamation are partly, in one way or another, restrictive of the free transfer of shares from one individual to another. On the contrary, the proclamation has strong provisions for the disclosure of information by banks that is very important for the well-functioning stock exchange.³ Seen in light of the legal development of an organized stock exchange law, this proclamation has both negative sides as it is highly restrictive in relation to transfer of share and positive sides in relation to its strong provisions regarding disclosure of information that is in case very crucial to reduce insider trading and fraudulent practices as well as selective disclose of information concerning the overall affair of the company and its shares. However, whatever their improvements and hindrances towards the legal development of stock exchange, these relevant laws issued and effective in the current regime are by no means sufficient for the establishment and effective running of a formal stock exchange in the country. Unlike that of the commercial code which has some rudimentary provisions these laws do not have rules which has to do with regulation of axillaries. There is still no a supervisory organ for stock exchange, no establishing law for the stock market, no law which regulate listing of shares and soon. In the regime of EPRDF there is no any significant legal development towards the development of an organized stock market in the country that the revival of the effectiveness of the commercial code and enactment of some specific amending laws of the code that has no a profound effect on stock exchange.

Despite this, it doesn't mean that there is no movement in the concerned government organs, in the academician and other stakeholders advocating towards the establishment of an organized stock exchange in the country. Some of the steps to be cited here as instances include the study undertaken by the National Bank of Ethiopia (NBE) in 1995 on the topic "Feasibility of Establishing of Securities Exchange Market in Ethiopia" and its draft securities and exchange proclamation, the organization of the Ethiopian Share Dealing Group under the Addis Ababa Chamber of Commerce and Sectoral Association in the year 2000 and its initiation of the development of the stock exchange rules and regulations as well as share dealing group and the development of an international rules and standards manual consisting of membership requirements, listing rules, requirement for insurers, listing of shares, listing of bonds, trading rules, rules for clearing and settlement of stock exchange transactions.⁴ Nonetheless, in spite of these efforts, the current government of the country is reluctant until now to come up with a legislative instrument that serves as a benefactor for the birth and well-functioning of an organized stock exchange. There has been an investigation on the whys of this reluctance from the side of the government. Accordingly, it is found out that the basic reason for this is the position of the government that an establishing an organized stock market is not the policy priority of the country.⁵

3. Conclusion Remarks

Stock exchange is an organized market place for the buying and selling of company and government securities.

¹ See for example, Commercial Registration and Business Licensing Proclamation, 1997, proc. No 67, Neg Gaz, Year 3, No. 25, Commercial Registration and Business Licensing (Amendment) Proclamation, 1999, proc. No 171, Neg Gaz, Year 5, No. 54, Commercial Registration and Business Licensing (Amendment) Proclamation, 2003, proc. No 376, Neg Gaz, Year 10, No. 9 which are all repealed and Commercial Registration and Business Licensing Proclamation, 2010, proc. No 686, Neg Gaz, Year 16, No. 42 which is currently effective. All of these proclamations donot have a provision that is relevant for the formation or other wise of an organized stock exchange in the country.

² Banking Business Proclamation, 2008, Arts. 10 & 11, proc. 592, Neg Gaz, year 14, No. 57.

³ Id. Arts. 28-31.

⁴ R. Ruecker, cited above at note 7, p. 2.

⁵ Tikikile Kumulachew, cited above at note 8, P. 60, see also R. Ruecker, cited above at note 7, p. 17.

Organized stock market is asserted very crucial for developing economies, like Ethiopia. Among others it is important to increase liquidity of investment capital, mobilize the necessary money from those who do not use it immediately to those who are in need of it, enhance good corporate governance. However, these benefits can be effectively reaped if there is a law which adequately regulates the stock exchange. It is worth of considering here that informal and unregulated security market is very dangerous to the investing business community as it exposes her to fraud, selective disclosure of relevant information, and finally affects the certainty and trust in commerce of securities.

The legal development of stock exchange in this country can be characterized as very rudimentary and so insufficient. Of course, there are some provisions in the commercial code which are relevant to stock exchange and there was also a private move to establish the market by way of organizing the Share Dealing Group which are indicative of a way to establish organized stock exchange in the 1960s, however, these ended with the coming of the Derg in the year 1975. The country continued without adequate and specific law for stock exchange in the current government. But, the number of share companies are increasing and it is an unavoidable to that there exists informal exchange of securities. In addition to this, the country is currently selling government bonds to support the project of the Great Renaissance Dam over the Abay River that reselling of the bond is inevitable over the informal market.

Hence, if we want to get the benefits out of organized stock exchange and protect our investors from the deficiencies of informal market securities above, I recommend that the government should come up with a law for establishment of stock exchange in the country.

4. Reference Materials

- 1) The commercial code of Ethiopia
- 2) Government Treasury bill (Bond) Proclamation, 1961, Art. 3, Proc. No. 172, Nega Gaz. Year 5, No 11.
- 3) The Premium Bonds Regulations, 1963, Legal Notice No. 274.
- 4) Legal Notice No. 334/1968,
- 5) Savings Bonds Regulations Legal Notice No. 275/1963
- 6) Legal Notice No. 294/1964
- 7) Legal Notice No. 342/1968
- 8) Legal Notice No. 368/1969
- 9) The Treasury Bills Proclamation, 1969, proc. No. 263.
- 10) The Special Authority of the Minister of Finance to Contract Loans and Guarantees Proclamation No. 247/1967.
- 11) Commercial Registration and Business Licensing Proclamation, 1997, proc. No 67, Neg Gaz. Year 3, No. 25,
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