CORPORATE GOVERNANCE RULES IN ETHIOPIA AND GERMANY: A COMPARATIVE ANALYSIS

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ABSTRACT

This thesis comparatively analyzes the corporate governance rules of the publicly owned corporations in Germany and Ethiopia. Stock corporations in Germany follow the 'two-tier' board structure composed of supervisory board and management board whereas the boards of directors of share companies in Ethiopia adopt a single tier board of directors. Employees participate in the supervisory board of stock corporations in Germany in the form of codetermination. However, the concept of employees' representation in corporate boards is unknown to the Ethiopian company law. The shareholders meetings are called in both jurisdictions to pass resolutions on important affairs of a company. Yet the scope of their powers varies across these two jurisdictions. The role of auditors in examining the financial flaws of companies is another important aspect of corporate governance in both jurisdictions and it will be comparatively studied. It is true that two jurisdictions can hardly have the exact same rules of corporate governance. Contrast to the literally imported rules of corporate governance in Ethiopia, Germany has legal regimes developed in its own environment. Ethiopia is on the verge of revising its old Commercial Code that is believed to have lagged behind the modern developments in corporate laws. It is expected that the experts in charge of the revision will consider corporate laws of foreign advanced economies such as Germany. The thesis will thus examine the differences and similarities between the rules of corporate governance of Germany and Ethiopia by focusing on the three important organs of public corporations: board of directors, shareholders meetings and auditors. Finally, what rules Ethiopia could possibly borrow from the corporate governance rules of Germany will be shown. The existing rules of corporate governance that Ethiopia should keep with slight or no modifications will also be identified.

CONTENTS

INTRODUCTION

In the capitalist world corporations are the sophisticated tools of pooling capital together to venture in businesses that require large investment. Once successfully formed, corporations have separate legal existence from their shareholders. Yet, corporations are represented and managed by human agents: directors and managers. The shareholders do not have a direct decision-making authority over their corporation. The day-to-day functioning of a corporation falls into the hands of few individuals. This divorce of shareholders from their corporation resulted in 'the separation of ownership and control'.[1] The separation in turn results in the risk of 'agency costs' as decisions and actions of managers/directors might lead to a catastrophic failure of a corporation.

The shareholders as 'owners' of a corporation, need to boost their investment values.[2] The management is supposed to work to realize this goal –not to exploit the company for their individual gains. Corporate governance helps to balance the conflicting interests of shareholders and the management. Traditionally, corporate governance was considered as a tool that guards the rights of shareholders only.[3] This view is no longer acceptable. The prevailing view now is– corporations are entities with a composite chain of relationships between many stakeholders. Thus, the objective of corporate governance is to protect these 'competing interests' of diversified stakeholders.[4]

[1] Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property, With a New Introduction by Murray L.Weidenbaum and Mark Jensen*, Transaction Publisher, UK,1991, p-66.
[2] Kraakman, Davies, Hansman, Hertig, Hopt,Kanda, Rock, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, New York, 2004, p-18.
[3] Kent Greenfield, *The Failure of Corporate Law*, University of Chicago Press, 2007, p-41.
[4] Kraakman et al., *supra note* no. 2, p-18.

Now let us define corporate governance and what it does. The literatures on corporate governance show that there is no universally applicable definition of corporate governance. Scholars and regulatory organizations define it differently from their own perspectives. The straightforward and a very broad definition is 'the system by which companies are governed and controlled'.[5] This definition is too general to give clear hints as to the scope and function of the corporate governance. A more elaborate definition is given by the Organization for the Economic Cooperation and Development (OECD). It reads:

> Corporate governance involves a set of relationships between a company's management, its board its shareholders and other stakeholders. It also provides the structure through which the objectives of a company are set and the means of attaining these objectives and monitoring performances are determined.[6]

The enumerations included in this second definition points out the multiple issues covered by corporate governance and its function to set, realize and monitor the achievements of a corporation. Still this definition is not a complete definition as it leaves out many key principles common in corporate governance discourse – notably –the issues of accountability of the managers, transparency and so forth. Not surprisingly, corporate governance encompasses several issues and there is no generally accepted definition of it. The emergence of corporate governance as an area of study is a recent phenomenon and the clear scope of corporate governance is not settled.[7]

Despite similarities in the objectives it seeks to achieve, corporate governance is structured differently in different jurisdictions. There is no ready-made system of corporate governance

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[5] Kevin Keasey and Mike Wright (ed.), *Corporate Governance: Responsibilities, Risks and Remunerations,* John Wiley & Sons Ltd, UK, 1997, p-121.
[6]OECD Principles of Corporate Governance, 2004, available at: http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf, (last visited march 01, 2015), p-11.
[7] Stefan Prigge, *A survey to German Corporate Governance,* in: Klaus Hopt,Hideki Handa et al.(ed), *Comparative Corporate Governance: The State of the Art and Emerging Research,* Oxford University Press, Oxford,1998,p-945.

that countries can easily implement.[8] Every model of corporate governance has its own merits and drawbacks. Consequently, countries have differing rules of corporate governances and two jurisdictions can hardly have the exact same rules of corporate governance.

Ethiopia has 'transplanted' most of its modern legal codes including the Commercial Code of 1960[9] from the then continental European legal codes. This code contains the general rules on corporate governance in Ethiopia. Other proclamations and directives were enacted to supplement the general rules in the Commercial Code. The Commercial Code recognizes board of directors, shareholders meeting and auditors as the three main organs of management of share companies. Contrast to the situation in Germany, only shareholders are allowed to serve as members of the 'one-tier' board of directors in Ethiopian share companies.[10] Shareholders meetings are called to pass resolutions on important matters of share companies. Finally, the auditors are appointed and entrusted with the task of examining the financial records of share companies.

Contrast to the single-tier board structure in Ethiopia, Germany adopted the 'two-tier' board structure made of management board and supervisory board. This model separates management from supervision. Unlike the membership requirement under Ethiopian Commercial Code, members of the management board and the supervisory board need not necessarily be the shareholders. As to be shown later, the corporate governance concept in Germany follows the 'stakeholder oriented' model. So, different stakeholders such as banks (as a creditor or a 'voting trustee') and employees are represented in the supervisory board of stock corporations.

[8]Klaus Hopt,Hideki Handa et al.(ed.), *Comparative Corporate Governance: The State of the Art and Emerging Research*, Oxford University Press, Oxford, 1998, p- 13.
[9] The Commercial Code of the Empire of Ethiopia, Negarit Gazzete Extraordinary Issue, Proclamation No. 166, May 5,1960 (herein under stated shortly as Com.C)
[10] Art-347(1) Com.C

Shareholders meeting do play important roles in the corporate governance of their stock corporations. One of the peculiar features of the German corporate law is the higher involvement of workers in the governance of companies in the forms of 'co-determination' and 'the workers council.' Auditors investigate the financial records of corporations in Germany as well.

This thesis conducts a comparative analysis of rules of corporate governance of publicly held companies in Germany and Ethiopia. Stock corporations in Germany have three main organs: the supervisory board, the management board and the general shareholders meeting.[11] However, in Ethiopia the Commercial Code lists shareholders meetings, board of directors and auditors as principal organs of management.[12] In order to make the coverage in both jurisdictions equivalent the role of auditors' in corporate governance in Germany will also be briefly discussed. This thesis acknowledges the recent increase in number of share companies and their potential contribution to the Economy of Ethiopia. This development will be sustainable only when it is supported by adequate legal and institutional regimes. When a country revises its laws or policies, it is inevitable to look at laws and policies of advanced economies. It will be shown that Ethiopia's corporate governance rules should be updated in order to better foster the growth of companies and protect the interests of stakeholders. The study will uncover if corporate governance rules of public corporations in Germany has suggestions to offer for its Ethiopian counterpart.

The structure of this thesis is as follows: the first section introduces the corporate laws, the recognized forms of companies and the sources of laws for corporate governance in Germany

[11] Jean de Plessis and Otto Sandrock, *The German System of Supervisory Codetermination by Employee*, in: Du Plessis J.J, Grobeld B. et al.: *German Corporate Governance in International and European Context*, Springer, 2007, p-111
[12] Art-347 and ff Com.C

and Ethiopia. The second section analyses the ‘two-tier’ board structure of stock corporations in Germany. The third section examines the ‘one-tier’ board structure in Ethiopian share companies. The fourth section deals with the roles of shareholders in the corporate governances in both jurisdiction and the protection of minority shareholders. The fifth section is dedicated to the roles of auditors in corporate governance of publicly held companies in Germany and Ethiopia. At the last, the paper concludes the findings of the study and makes recommendations.

1. A BRIEF ACCOUNT OF CORPORATE LAWS AND CORPORATE GOVERNANCE REGIMES

This first chapter introduces the common forms of companies recognized in Germany and Ethiopia. A brief explanation of the common characteristics and the formation of these forms of companies will be provided. After discussing the forms, a short account of the legal regimes for corporate governance in both jurisdictions will be covered. As the thesis largely addresses public companies, the corporate governance rules of private limited companies will not be discussed in detail.

1.1. Germany

Corporations under German corporate law can have two forms, i.e. Stock Corporation, *Aktiengesellschaft* (hereinafter referred to as, AG) and Private Limited Company, *Gesellschaft mit beschränkter Haftung* (hereinafter referred to as GmbH). AG and GmbH are regulated by different legislations.[13] Nevertheless, there are some main rules of corporate law applicable to both AGs and GmbHs.[14]The German Stock Corporation Act of 1965 (*Aktiengesetz*) with its subsequent amendments and modifications regulates AGs. On the other hand, GmbHs are governed by the old Limited Liabilities Companies Act (GmbHG) of 1896 with its recent amendments in New Limited Liability Act in 2009. It was last amended by article 27 of the Act of 23 July 2013.[15]

[13] Theodor Baums, *Corporate Governance in Germany-System and Current Developments*, 1999, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=158038 , (last visited on December 25, 2014), p-1.
[14] Ibid.
[15] See: http://www.gesetze-im-internet.de/englisch_gmbhg/englisch_gmbhg.html, (last visited on February 3, 2015).

Compared to Stock Corporations, GmbHs have less strict formalities and costs, which makes them ideal for 'closely held and subsidiary corporations'.[16] A single person can establish GmbH and be its only shareholder.[17] This form of company can be set up with a minimum of 25,000 Euros.[18] Similar to the stock corporations GmbHs provide a limited liability for its members.

AG is a form used mainly by large corporations whose shares are publicly held and traded on stock exchanges. Unlike stock corporations, GmbHs cannot be listed on stock exchanges.[19] Pursuant to §2 of the Stock Corporation Act one or more members are required to form an AG.[20] They need not be German or domiciled in Germany.

The legal regime of corporate governance in Germany is composed of various legislations such as: the Stock Corporation Act of the 1965 with its later amendments, the Commercial Code, the Co-determination Act of 1976 and other statutory materials. The basic obligatory structure of corporate governance of AGs is laid down in the Stock Corporation Act of 1965.[21] In addition to the compulsory rules under this Act, a set of optional 'best-practices and recommendations' under the Corporate Governance Code[22] are gaining a significant acceptance in Germany.[23] Nevertheless, it is not an authoritative law and its application is not obligatory.

[16] Hannes Schneider and Martin Heidenhin, *The German Stock Corporation Act*: *Bilingual Edition with an Introduction to Law****, 2nd*** ed, Kluwer Law International, Munchen, 2000, p- 3.
[17] § 1 GmbHG.
[18] § 5 GmbHG.
[19] Ernest C.Steefel and Bernhard von Falkenhausen, *The New German Stock Corporation Law*, Cornell Law Quarterly, Vol-52, 1967,p-518(accessed from <heinonline.org> last visited on March 07,2015
[20] In contrast, the existing company rules in Ethiopia do not allow the formation of a share company with a single shareholder.
[21] Carsten van de Sande in: Willew JL Calkoen (ed.) *Corporate Governance Review*, Law Business Research LTD, 2011, p- 118.
[22] The Corporate Governance Code, as amended on June 24, 2014, available at: http://www.dcgk.de//files/dcgk/usercontent/en/download/code/E-CorpGov_2014.pdf., (last visited on March 01,2015).
[23] Sande,*supra note* no 21, p-118.

1.2. Ethiopia

Compared to Germany, the development of companies and company laws in Ethiopia is a recent phenomenon. The 1931 Company and Bankruptcy Law was the first codified company law made by the then imperial government. In 1960, Ethiopia had its major legal codes including the Commercial Code.[24] The codes contained legal concepts transplanted mainly from the continental European legal codes. The country has no separate statute for share companies (publicly owned corporations).

In Ethiopia, the general Company law matters are governed by the Commercial Code of 1960 and several other complimenting or sector specific proclamations and directives. Title VI (Art 304-Art 509) Book II (Traders and Business Organization) of the Commercial Code deals with 'companies limited by shares' whereas Title VII of the same book and title governs Private Limited Companies.

The Commercial Code recognizes two forms of companies: share companies and private limited companies. Art-304 of the code provides the typical features of share companies. First, founders of a share company decide its capital in advance and divide it into small sections –shares. Secondly, the liability of a share company is met by its own assets only. Should the creditors claim is not satisfied by assets of a company, creditors cannot proceed to personal properties of shareholders. In fact, it is understood from the cumulative readings of Arts -510(1) &304 of the Commercial Code that both share companies and private limited companies in Ethiopia protect their shareholders by providing limited liabilities.

[24] Paul Brietzke, *Private Law in Ethiopia*, Journal of African Law, Vol-18, No. 2, 1974, p- 1.

The two forms of companies in Ethiopia have different requirements of formation, minimum capital, organs and structures of management, issue and transfer of shares etc. Setting up a share company requires at least five members as per Art-307(1) of the Commercial Code. Nevertheless, the law does not pose restriction on the maximum number of shareholders a share company can have. The minimum capital to set up a share company is 50,000 Ethiopian birr.[25] This amount is equivalent to 2145 Euros and obviously, it cannot run a share company today. In fact, this minimum amount of capital is already amended as far as financial share companies are concerned. The removal or modification of the existing rules and the introduction of new rules are expected in the proposed new Commercial Code.

Private limited companies are the most widely utilized form of companies in Ethiopia. Owing to their simple governance structure and presumably limited capital, the law prohibits private limited companies from taking part in ventures such as banking and insurance.[26] Similar to German GmbHs, private limited companies in Ethiopia cannot go public to raise finance. Their shares are divided only between the founders. Nevertheless, a private limited company can transform itself to a share company by offering its share to the public. The minimum number of members this form of company has to have is two and it cannot have more than 50 members.[27]

The development of public share companies in Ethiopia is a very recent phenomenon. The socialist system of government was overthrown by in 1991 and it was only after this regime change that the country has experienced a market economy. The number of private limited companies established following this change of regime is significantly high compared to share

[25] Art-306 Com.C.
[26] Art-513 Com.C.
[27] Art-510(2) Com.C.

companies.[28] This is attributed partly to the relative ease of forming private limited companies compared to share companies. Yet, the country has low level of expertise, and low investor confidence in establishing share companies. The demand for shares is low because of the lack of stock exchange market and the resulting shares illiquidity.

The rules in the formation and governance of public share companies are stricter and more complex than those governing private limited companies. This is apparent from the process involved starting from issuing of a prospectus to the successful establishment of a share company, not to mention its more complicated governance structure. For instance, Art-525 of the Commercial Code states that private limited share company is governed by 'one or more managers' and shareholders meeting is not required unless the firm has above 20 members. A typical private limited company in Ethiopia has less than ten shareholders who are usually members of a family or close friends.

The general company law rules under the Commercial Code are often overruled or augmented by special rules of the same code or other separate proclamations and directives. For example, a separate proclamation governs the matters of registration and business licensing of companies.[29] Besides, financial share companies are subjected to special laws in addition to the general rules embodied under the Commercial Code.[30] Hence, the Banking Business Proclamation No.592/2008 and Insurance Business Proclamation No.764/2012 govern banks and insurance companies respectively. The micro finance institutions are governed by Proclamation No.

[28] Fekadu Petros, *Emerging Separation of Ownership and Control in Ethiopian Share Companies: Legal and Policy Implications*, Mizan Law Journal, Vol- 4, No-1, 2010, p- 13.

[29].Commercial Registration and Business Licensing Proclamation No.686/2010, and amendment thereof (Proclamation No.731/2012) (both available at: http://www.mot.gov.et/web/pages/trade-proclamations, (last visited on Jan 04, 2015).

[30] It is submitted that the potential risks of instability of the financial system and macro economy has prompted the government to maintain a closer watch and stronger regulation over financial institutions.

629/2009. Share companies other than financial institutions are largely subject to the general rules under the Commercial Code.

In conclusion, this chapter has shown that the ‘separation of ownership and control’ has led to the development of corporate governance rules as a means to protect the interests of stakeholders. Corporate governance as a concept does not have a universally accepted definition as such. In both Germany and Ethiopia the forms companies greatly affect its structure of corporate governance. In Germany, the forms of companies are classified into AG (stock corporations) and GmbH (private limited companies) and they are governed by different legislations. Share Companies and private limited companies are the two typical forms of companies in Ethiopia as well. The principal bodies of corporate governance in ‘publicly owned companies’ in Germany are shareholders meetings, board of managers and the supervisory board. In Ethiopia the Commercial Code clearly lists the shareholders meetings, the board of directors and auditors as ‘organs of management’. The corporate governance rules of the public companies in Germany and Ethiopia will be analyzed in the subsequent chapters focusing on these main organs of corporate governance.

2. 'TWO-TIER' BOARD MODEL IN GERMAN STOCK CORPORATIONS

This chapter analyzes the distinctive structure of board of directors in open corporations in Germany―the separation of management board and supervisory board. It is compulsory for a typical AG in Germany to have these two organs.[31] The Management board is in charge of the day-to-day functions of a corporation whereas the supervisory board as evident from its name supervises and advises the management board. The appointment, dismissal, rights, duties and liabilities of the management board and of the supervisory board will be discussed in this chapter.

2.1. Management Board (Vorstand)

This is the first level of the mandatory two-tier board structure in the German stock corporations. The Management board is an organ with a significant power that is responsible for the actual management of a stock corporation.[32] In principle, the management board is autonomous from the shareholders and the supervisory board in its regular functions. Nonetheless, actions of the board should protect 'the best interest of the corporation'.[33] Below we will see the manners of appointment, removal, duties and liabilities of this organ under the German Stock Corporation Act.

2.1.1. Appointment, Dismissal and Remuneration

In principle, the supervisory board appoints the members of the management board.[34] Legally speaking, appointment carries with it the right to enter into the employment contract with the

[31] Wirth, Arnold, Morshauser, & Greene, *Corporate Law in Germany*, 2nd ed., C.H Beck, Munchen, 2010, p-98.
[32] §76(1) AktG.
[33] Wirth et al., *supra note* no 31, p-109.
[34] § 84 AktG.

appointed manager.[35] If the management board is short of members to pass the necessary corporate decisions, a concerned person can bring application to the court of law which is authorized to make appointments in 'urgent cases'.[36] Whatever the case might be, shareholders have no direct say in the selection of the management board.

As the position requires high commitment, expertise and loyalty, the articles of association may prescribe certain qualifications that members of the management board should possess. The statutory qualifications are also provided. For instance, section 76 of the Stock Corporations Act provides various statutory limitations on the qualification to serve as a member of the board of managers. First, only a natural person free from any legal or judicial interdiction can serve as a member. Secondly, a person convicted of financial crimes like bankruptcy or fraud 'within the last five years' do not qualify to serve as a member. It follows from the limitations that appointments made in breach of these qualifications would be null and void.[37] The supervisory board may also consider auxiliary external conditions such as representation of women and maintaining diversity.[38]

The supervisory board is authorized to revoke the appointment of the management board for 'good cause'.[39] 'Good cause' constitutes– 'a gross breach of duties', 'inability to run the company', or a 'vote of no confidence by the shareholders'.[40] Following the dismissal, the legal questions such as what will happen to the contract of employment of the dismissed manager may arise. The revocation of the appointment by the supervisory board may not terminate the

[35] Willi Joachim, *The Liability of Supervisory Board Directors in Germany*, The International Lawyer, Vol-25, No-1, 1991, p-50.
[36] §85 (1) AktG.
[37] Wirth et al., *supra note* no 31, p-104.
[38] German Corporate Governance Code section 5.1.2.
[39] §84(2) AktG.
[40] §84(2) AktG.

manager's rights under the contract of service with the company.[41] In fact, not all the grounds of dismissal are attributable to the fault or negligence of a manager. The lack of physical or mental fitness to carry out the managerial function could arise from sickness. In this specific case, a person has the right to receive remuneration and pension for the remaining term of his office.[42]

The management board is entitled to remuneration for the services they render as per section 87 of the Stock Corporation Act. This provision states that the supervisory board determines the amount of remuneration. The modes of compensation include: 'salary, profit participation reimbursement of expenses, insurance premiums, commissions and additional benefit of any kind'. The management board members are also entitled to extra benefits like 'widow pension', 'orphan pension' and sometimes 'stock options.'[43] It is an established practice in almost all jurisdictions to keep the records of payments made to managers as salaries. The same is true in Germany as the companies are duty bound to keep records of these sorts. Thus, the detail registers of compensations paid to the members of board of directors should be included in the company's financial records.[44]

2.1.2. Duties and Personal Liabilities

Corporate managers' duties in Germany have different sources. The prominent sources include laws, the corporate governance code, decisions of courts and the documents of the company.[45]The management board has the duty to conduct its management activities in the 'best interest of the company'.[46] This duty carries with it a number of other duties such as duty of

[41] Steefel and Falkenhausen, *supra note* no-19, p-528.
[42] Steefel and Falkenhausen, *supra note* no-19, p-528.
[43] Wirth et al., *supra note* no 31,p-108.
[44] Wirth et al., *supra note* no 31, p-108(also see §285(9) of German Commercial Code).
[45] Gubitz, Nikoleyczik & Schult, *Manager Liability in Germany*, CH.Beck, Munchen,2012, p-1
[46] Wirth et al., *supra note* no 31, p-109.

care, [47]fiduciary duty,[48] duty to obey the laws, duty of confidentiality[49] and duty to furnish information to the supervisory board.

The breach of the directors' duties may entail serious consequences on the company and its stakeholders. The breach of duties could be internal (against the company itself) or external (when it is committed vis-a-vis the outsiders such as customers, workers and shareholders).[50] For both types of breaches there must be legal tools to hold the management board responsible for their blameworthy conducts. In other words, there ought to be legal consequences of their breaches.

In Germany there is no strict liability (liability without fault) of the management board for the financial losses either the company or its creditors suffer.[51] In the world of business, a venture could be profitable or it may end up in losses. The managers or directors of the company will not be personally liable for every loss the company sustains unless they violate their duties intentionally or negligently.[52]

The notion of 'business judgment rule' protects managers from liability for the 'entrepreneurial decisions' that may negatively affect the company.[53] The concept was originated in the US legal system and included into the German Stock Corporation Act in 2005.[54] The management board is not subjected to liabilities towards the company for business decisions it believed in good

[47] §93(1) AktG.
[48] For instance, obligation not to compete with the corporation (§88 AktG).
[49] §93(1) AktG.
[50] Karin Madisson, *Duties and Liabilities of Company Directors under German and Estonian Law: A Comparative Analysis*, Riga Graduate School of Law Research Papers, No-7, 2012, available at: http://www.rgsl.edu.lv/uploads/files/7_Karin_Madisson_final.pdf, (last visited on March 05, 2015), p-13.
[51] Ibid.
[52] Ibid.
[53] Gubitz, et al., *supra note* no-45, p-4.
[54] Markus Roth: *Outside Directors Liability: German Stock Corporation Law in Transatlantic Perspective*, Journal of Corporate Law Studies, Vol-8, 2008, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1680246, (last visited on March 13, 2015), p-9.

faith to be profitable for the company. Even when the decision is a ‘business decision’, the management board will not be exempted unless it acts upon an informed basis.[55]

The ‘business judgment rule’ provides a significant protection to the management board. Otherwise, if the board is subject to liabilities for every business decisions, it hinders its independency and the efficient management of firms. But, §93 of AktG puts the onus of proof on the sued director to prove that he/she has acted in good faith while deciding the matter which resulted in financial loss to the company. This is difficult to the sued director especially if the legal proceeding is instituted after he/she has already left the office. One of the reasons is the documents or evidences may not be conveniently available to the sued director.

The rules on the personal liabilities of the management board play a remedial as well as ‘preventive functions’.[56] The remedial role as evident from its name involves the proceeding in which directors (for instance due to bankruptcy) could be sued by trustees.[57] Normally the AG is represented by its managers. In principle, if the number of management board is more than one they should represent the company jointly.[58] Nevertheless, the articles of association may provide situations were individual members could be authorized to represent a company.[59] The implication of this joint representation is that the breach of the duties of the management board entails the joint and several liabilities of its members.

[55] §93 (1) AktG.
[56] Baums, *supra note* no 13, p-4.
[57]Baums, *supra note* no 13, p-4.
[58] §78(2) AktG (see also §81 of the AktG. which imposes the duty on the management board to report changes in the composition and its powers to represent a company to its commercial register and ensure its registration).

[59] §78(2) AktG.

2.2. Supervisory Board (Aufsichtsrat)

It is submitted that corporate law of Germany is a 'stakeholder oriented' system that obligates the representation of constituencies other than shareholders in the board of directors.[60] The Supervisory board is the prime manifestation of this model. It is the second level of the board of directors in German stock corporations that serves as an organ representing shareholders, employees and sometimes other constituencies as well. The powerful constituencies often represented in the supervisory board are 'workers representatives', banks and 'block holders'.[61]

A German stock corporation is obliged to have the supervisory board. Its composition in principle depends on the size of a corporation. For AGs with less than 2000 employees, the members are mainly from the representatives of shareholders and other constituencies like banks. However, when the AG employs more than 2000 workers it should include some of its members from the representatives of labor.[62] The main function of this organ is to appoint and revoke the management board and oversee the overall management of a corporation.[63] It is also responsible for bringing the actions of the company against members of the management board.[64]Below we will see the appointment, dismissal, remuneration, duties and personal liability of the board of supervisors under the German Stock Corporations Act in a more detail. The supervisory codetermination as a platform to ensure employee participation in the governance of corporations in Germany will also be discussed.

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60 Hackethal, Schmidt and Tyrell, *Corporate Governance in Germany: Transition to a Modern Capital –Market-Based System?* Journal of Institutional and Theoretical Economics, Vol.159, No.4, 2003, p-664.
61 Ibid., p-665.
62 Normally the Codetermination Act applies to the composition of the supervisory board for a corporation with more than 2000 workers. According to § 7 of the Co-determination Act, 1976: for AG with less than 10,000 the supervisory board should be composed of six employee representatives and six shareholders representatives. For AGs with 10,000 up to 20,000 employees the board of supervisors is composed of eight members form the employee's representative and eight from the shareholders representatives. If AG employees more than 20,000 workers the law requires ten representatives of shareholder and ten representatives of workers.
63 §111 AktG.
64§112 AktG.

2.2.1. Appointment, Dismissal and Remuneration

Unlike the management board, members of the board of supervisors are installed by the shareholders meeting and the employees when the Co-determination Act applies.[65] The representatives of shareholders in the supervisory board are elected by the ‘simple majority’ of the shareholders meeting.[66] However, the representatives of labor are chosen from the current workers of the corporation and the ‘trade union representatives’.[67] Due to their incompatible functions, the law prohibits double membership of a person to the board of supervisors and the management board. As a result, members of the supervisory board cannot serve as the members of the management board and vice versa.

There are different modes of dismissing the members of the supervisory board. For the dismissal of the supervisory board members elected by the shareholders meeting, the three fourth majority vote is required.[68] The supervisory board itself can request the court of law to dismiss a concerned member for ‘good cause’.[69] What constitutes a good cause is submitted to be the same with the standard for the removal of the management board.[70]

Either the statutes of the company or resolution of the shareholders meeting has to provide the compensation for the supervisory board members.[71] The actual situation of a corporation and the magnitude of duties of the board members are significant in fixing a ‘reasonable remuneration’

[65] §101 AktG(co-determination applies to AGs with above 2000 workers).
[66] Jeremy Edwards and Marcus Nibler, *Corporate Governance in Germany: The Role of Banks and Ownership Concentration*, Economic Policy, Vol-15, No-31, 2000, p-241.
[67] § 7(2) of the Co-determination Act, 1976.
[68] §103 AktG.
[69] §113(1) AktG(§84(2) AktG lists: ‘a gross breach of duties’, ‘inability to manage the company’, or a ‘vote of no confidence by the shareholders’ as the grounds constituting ‘good cause’ for the dismissal of the members of the board of managers).
[70] Wirth et al., *supra note* no 31, p-121.
[71] §103 AktG.

for the supervisory board.[72]The mode of payment constitutes a fixed income with extra sum based on the net profit of the corporation.[73] This mode of compensation is preferred because it takes into consideration the long-term business goals of corporations. That is why the German Code of Corporate Governance favors and recommends such system of supervisory board remuneration.[74]

2.2.2. Duties and Personal Liabilities

Functions of the supervisory board are its duties a breach of which exposes them to liability provided under sections 116 and 93 of Stock Corporation Act. The cumulative reading of these two provisions shows that the rules governing the liabilities of management board and the supervisory board are the same.[75] Moreover, both are subjected to joint and several liabilities for the blameworthy breach of their duties.

The primary duty of the board of supervisors is to oversee the board of managers.[76] Supervision among other things includes inspection of the books, records and assets such as 'cash, securities and merchandise' of the corporation.[77] The board of supervisors' right to inspect the financial records of a company includes the right to request outside experts to examine the company's financial records.[78] Furthermore, the function of the board of supervisors is augmented by the

[72] §113(1) AktG.
[73] Wirth et al., *supra note* no 31,p-128.
[74] German Code of Corporate Governance, sec. 5.4.6.
[75] Gubitz et al., *supra note* no-45, p-17.
[76] Yet this duty of supervision doesn't extend to the staff below the management board. Normally it is the function of the management board to supervise those employees.
[77] §111(2) AktG.
[78] §109 AktG.

management board's duty to make regular reports on 'corporate policy and corporate planning', 'profitability of the company' and its overall progress.[79]

If under the bylaws of the corporation certain transaction requires the approval of shareholders meeting, it is the duty of the supervisory board to secure one.[80] In the course of discharging its functions, the supervisory board, in principle, has the right to establish committees, assign its members, and delegate some of its functions.[81] Still, certain functions cannot be delegated. For instance, by its very nature the right to appoint and dismiss the management board and calling the shareholders meetings cannot be delegated to committee members or experts.[82] In these scenarios, the board of supervisors has to perform its functions itself.

Similar to the management board, the supervisory board has the 'duty of care' while carrying out its functions. The standard of care expected of the board of supervisors is that of a 'diligent person'. This duty calls for the members to have the required knowledge of supervision as well as willingness to receive professional trainings provided by their corporation.[83] Failure to seek expert advice on certain matters or unwillingness to receive the required professional training exposes the board of supervisors to personal liabilities.[84]

The supervisory board owes the fiduciary duties to the company. This includes keeping the company's secrets, avoiding unfair self-dealing with a company, and avoiding any conflict of interest with their company.[85]

[79] §90 AktG.
[80] §111(4) AktG.
[81] §107 AktG.
[82] §107 AktG.
[83] Gubitz, et al., *supra note* no-45, p-18.
[84] Ibid..
[85] §116 and § 93 of AktG).

Member of the supervisory board have their calling elsewhere and their involvement in the daily business operation of the company is minimal.[86] Their involvement is more of ‘part-time’ and this should be considered in determining their personal liability.[87] The directors are expected not to interfere hugely in the function of the management. Yet, that does not mean it should supervise ‘too leniently’ and expose itself to liability.[88]

2.2.3. Supervisory Co-Determination in German Stock Corporations

Involvement or participation of employees in the decision making of corporations takes place in many jurisdictions. Yet it takes different forms and degrees. Germany has recognized the notion of codetermination since 1920s.[89] This system has helped to ensure the representation and ‘consultation’ of workers in corporate decisions both at ‘establishment’ and board levels.[90] The representation at the board level –‘supervisory codetermination’– is the focus of this sub-topic. Co-determination enables the employee representatives to participate in the supervisory board of their company.[91]

Currently the composition and overall aspects of the supervisory co-determination in Germany is governed by different legislations depending on the nature of corporation. Consequently, the Codetermination Act of the 1976 governs the composition of supervisory board of corporations

86 Joachim, *supra note* no 35, p-43.
87 Ibid.
88 Ibid., p-50.
89 Rebecca Page, *Co-Determination in Germany: A Beginners' Guide*, Arbeitspapier33, Hans Bokler Stiftung, 2009, available at: http://www.boeckler.de/pdf/p_arbp_033.pdf , (last visited on March 09, 2015), p-5.
90 Ibid.
91 Fukuyama Fransis, *Trust: The Social Virtues and The creation of Prosperity*, Free Press,1995,p-217.

other than the coal, iron and steel corporations which has a separate Codetermination Act of 1951.[92]

In accordance with the 1967 Codetermination Act a corporation with more than 2000 workers is obliged to have employee representatives in the board of supervisors.[93]The numbers, composition and manners of appointment of the employee representatives are governed by this Act. Accordingly, for AG with less than 10,000 the supervisory board should be composed of six employee representatives and six shareholders representatives.[94] For AGs with 10,000 up to 20,000 employees the board of supervisors is composed of eight members from the employee's representative and eight from the shareholders representatives.[95] If AG employees more than 20,000 workers the law requires ten representatives of shareholder and ten representatives of workers.[96] The employees' representatives themselves are composed of the current workers of the company and 'trade union representatives'.[97]

Despite the established norm of co-determination in Germany, there are criticisms and calls for changes to the system in law and policy due to legal developments in the European Union. Critics, among other things, forward: the board of supervisors increased focus on the labor matters instead of supervising the management board, the increasing number of membership hampers the smooth decision making in the board of supervisors, the exclusion of the companies workers abroad, and the possible conflict of interests.[98]These potential problems coupled with

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[92] This act calls for the one third membership of workers representatives in the supervisory board of the coal, iron and steel corporations.
[93] § 7(1) of the Co-determination Act, 1976.
[94] Ibid.
[95] Ibid.
[96] Ibid.
[97] § 7(2) of the Co-determination Act,1976
[98] Jean du Plessis and Ingo Saenger,*The German System of Supervisory Codetermination by Employees*, In:Du Plessis et al., *German Corporate Governance in International and European Context*, Springer, 2007,p-125-127.

the decisions by the European Court of Justice and legal developments at the European Union level may bring changes to the legal rules regarding the supervisory codetermination of workers in Germany in the future.

In conclusion, this chapter has examined the two level board structures of German stock corporations. It has discussed the manner of appointment, composition, dismissal, the respective duties and personal liabilities of both levels of boards. Finally, though Germany has been notorious for its representation of both ‘labor and capital’ in the supervisory board the current developments in European Union and other criticisms towards the efficiency of the supervisory determination may bring chances for the reconsideration of this policy and law in the long run.

3. 'ONE-TIER' BOARD MODEL IN ETHIOPIAN SHARE COMPANIES

Unlike the German model, Ethiopia adopts a single-tier board of directors. Whilst private limited companies are run by one or more managers, the primary organ of corporate governance of share companies in Ethiopia is the board of directors. Ethiopian rules of corporate governance do not recognize the two level board structure. As a result, the institution of co-determination is entirely unknown. This chapter analyses the board of directors in Ethiopian share companies in comparison with the board model in Germany. The manners of appointment, composition, functions, duties and liabilities will be dealt with. It will be shown that adopting the German type supervisory board is unlikely to work in Ethiopia. Instead, the function of supervision of management can be better achieved by introducing the mandatory external (non-executive) members in the board of directors.

3.1. The Board of Directors

Board of directors is one of the three organs of share companies recognized under the commercial code of Ethiopia. It is the highest organ of management in Ethiopian share companies. As stated earlier, private limited companies –the most widely utilized form of companies–are managed by one or more managers.[99] Nevertheless, it is mandatory for share companies to have the board of directors. One distinguishing feature under the Ethiopian legal system compared to its German counterpart is that only shareholders qualify to serve in the board of directors.[100]The minimum number of members a board of directors can have is three

[99] Art-525(1) Com.C.
[100] Art-347 Com.C.

and the law puts the maximum number as twelve.[101]Art-347(4) of the code states bodies corporate may be directors, but the chairperson of the board of directors shall be a physical person.[102] There is the view that the existing Ethiopian does not have adequate laws on matters such as ‘the separation of supervision and management’.[103] The same holds true for the membership, autonomy and compensation of the board of directors.[104] A study is underway to modernize the code in general. The upcoming Commercial Code is expected to tackle issues that are not well addressed under the existing rules. The discussion below is mainly on the existing rules of the commercial code and other proclamations on matters relating to the board of directors of share companies in Ethiopia.

3.1.1. Appointment, Dismissal and Remuneration

The first directors are appointed under the memorandum and articles of association and submitted to the ‘meeting of subscribers’ for confirmations.[105] In accordance with art-320 of the commercial code, the meeting of subscribers is called subsequent to the expiry of the period for the application of shares. At this first meeting of subscribers, the final memorandum and articles of associations will be drawn and all necessary appointments of the board of directors will be made. The subsequent directors are appointed by the meeting of the shareholders.[106]

There are differences between appointments, dismissal and remuneration of board of directors of financial share companies and non-financial share companies. The existing rules regarding

[101] It is up to the company to decide how many members its board of directors would have within this limitations of the law under Art- 347(3) of Com.C

[102] in Germany's, management board and supervisory board only natural persons can serve as a member

[103] Hussein Ahmed Tura, *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-i.

[104] Ibid.

[105] Art-350 Com.C.

[106] Art-321(4) Com.C.

the appointment of board of directors for non-financial companies does not say anything about the qualification of directors except a requirement of being a shareholder. Conversely, the laws governing financial share companies, subject directors, 'chief executive officers' and 'senior executive officers' to meet the competency requirements and approval of by the National Bank.[107] These requirements are prescribed only for financial share companies. The absence of equivalent requirement for the directors of 'non-financial share companies' creates the possibility that 'incompetent and mediocre' members could be elected to the membership.[108] Though this stricter regulation reflects the higher government interests in the financial share companies as evident from the amount of proclamations and regulations enacted to date, it is important to introduce qualifications for the directors of non-financial share companies as well. In addition, experiences from Germany such as disqualifying persons convicted of financial crimes notably fraud and insolvency could be relevant to consider.

Under Ethiopian law, the power of removing directors is entrusted to the 'ordinary general meeting' of shareholders.[109] With the absence of the supervisory board entrusted with the power of dismissing the members of the management board in Ethiopia, there seems no better alternative than authorizing the shareholders meetings. Yet a member of the board can be dismissed only for a 'good cause'.[110] A director dismissed without 'good cause' has the right to claim damages.[111] The code does not define what constitutes 'good cause' and there is no judicial decision to clarify what specifically constitutes a 'good cause' either. In the ordinary

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[107] See Art-5(1) (f) of Micro Finance Business Proclamation No.626/2009, Art-4(1) (g) of A proclamation to Provide for Insurance Business: Proclamation No.746/2012 and Art-4(1) (g) of Banking Business Proclamation No.592/2008.
[108] Hussein Ahmed Tura, *Reforming Corporate Governance in Ethiopia: Appraisal of Competing Approaches*, Oromia Law Journal, Vol-3,No-1, 2014, available at: http://www.ajol.info/index.php/olj/article/view/107620/97471, (last visited on March 06, 2015), p-185.
[109] Art-354 Com.C & Art-419 Com.C.
[110] Art-354 Com.C.
[111] Art-354 Com.C.

sense of the term, the violation of directors of their duties under the law and statutes of the company and failure to act in the standard of behavior imposed by the law entails personal liabilities. Financial share companies often are subjected to stricter regulation and control by the government. It has gone to the extent of authorizing the National Bank to dismiss the members of the board of directors of financial share companies for 'good cause'[112]

As examined in the preceding chapter the compensation of the management board in Germany is fixed by the supervisory board. However, in Ethiopia, the remuneration is determined either by general meetings of shareholders or in the statutes of companies.[113] In the nonexistence of an independent supervisory board to decide the salaries of the board of directors, no company organ other than the shareholders could be in a better position to decide. Due to the conflict of interests between the board of directors and the risk of possible 'excessive remuneration', the law authorizes shareholders meeting to decide salaries of the directors. The rules for financial share companies are often different as the external regulatory agency (The National Bank) is entrusted with an extensive powers including the power of determining the amount of directors' salaries. For instance, the annual remuneration of a bank director shall not exceed 50,000 Birr (equivalent to 2457 USD) and the monthly allowance shall not exceed 2000 Birr (equivalent to 98 USD).[114] It is highly doubtful if this much intervention from the government is appropriate. Besides, an inadequate remuneration may affect the directors' performance.

[112] See Art-17(1) of Banking Business Proclamation No.592/2008.
[113] Art 353 Com.C.
[114] Art-4 Limits on Board Remuneration and Number of Employees who sit on a Bank Board Directives No.SBB/49/2011.

The remunerations of directors have different modes. In principle, it is in the form of fixed periodic salary irrespective of the company's financial success.[115] Nevertheless, directors may be entitled to remuneration provided under articles of association in the form of 'share in the net profit' not more than ten percent of the net profit.[116] Under this mode of remuneration, the amount of pay is not a fixed sum. Its amount rather, depends on profits of the company. Thus, if there is no profit, there will be no remuneration.

No doubt, that directors shoulder a huge responsibility and they will indeed work harder to keep the company successful when they are remunerated well. Compared to Germany, the corporate sector in Ethiopia is not at its advanced level. Expectedly, the remuneration received by directors in Ethiopia is considered too small compared to company directors' remuneration in comparable jurisdictions. There is a likelihood that this could affect the performance of the board of directors.

3.1.2. Duties and Personal Liabilities

The duties of directors emanates from legislations, the statutes of the company and resolution of the shareholders meeting.[117] Unlike in Germany there are no judicial decisions expounding and setting the standard of behavior of conducts of directors in Ethiopia.

The duties of directors among others constitute: keeping 'the regular record of the management', 'keeping accounts and books' and reporting them to auditors, calling the shareholders meetings, and helping the company in its process in the case of dissolution of a company.[118] The law

[115] Art 353 Com.C.
[116] Ibid.
[117] Art-364 Com.C.
[118] Art-362 Com.C.

recognizes that directors owe the duty of ‘due care and diligence’ towards the company.[119] The standard of this duty of care is equated to the duties of an agent in agent-principal relationship. As rights and duties between an agent and principal are governed by the provisions of Civil Code, the relationship between a company and its directors is also subjected to these rules.

Even though the commercial code has not used the expression of ‘the best interest of the company’, it in fact, requires directors to work towards the returns of the company. They have the duty to prioritize the interests of the company in their everyday routines. Failure to avoid or minimize acts injurious to the company's interest within their knowledge or failure to act with ‘due care and diligence’ entails a joint and several liability.[120] Nevertheless, a director who has had his dissenting vote entered in the directors’ minute is exonerated from the board's decision that turned out to be disadvantageous to the company.[121] The board of directors in Ethiopian share companies are liable towards their company (internal liability) for their blameworthy conducts only. That is only when directors act knowingly or negligently.[122] There is no liability without fault (strict liability) and liability for the actions of others (vicarious liability) as afar as the internal liability is concerned. Unlike directors of German Stock Corporation, directors in Ethiopian share companies are subjected to ‘strict liability’ towards the creditors.[123] The law does not require blameworthiness of their decisions for their external liability towards creditors. The only requirement under this rule is the fact that the assets of the company cannot satisfy the claims of creditors.

[119] Art-364 Com.C.
[120] Ibid.
[121] Ibid.
[122] The cumulative readings of Arts-364 and 365 of the Com.C.
[123] Art-366 Com.C.

The legal issue that arises in relation to the liability of director is the question—who can sue the board of directors when they committed conducts against the law or statues of the company. The law requires resolution of shareholders representing at least one fifth of the capital before suing the directors.[124] If the company is not willing to institute a case against the director within three months after the resolution is passed, the law authorizes, the section of the shareholder to bring an action against the director.

Yet these rules do not entitle individual shareholders to sue the board of directors in the name of the company.[125] Of course, it seems logical in principle to deny individual shareholders to sue for every trivial allegations he/she might have since this could harass the board of directors.[126] Even when the interest of the company is affected by the fault of directors and the general meeting vote against the institution of the case before the court of law, no one can bring the case to the court of law. It is up to the shareholders to settle the matter outside the court of law.

Should an individual shareholder be 'directly affected' by the fraud or fault of the board of directors, Art-367 of the code entitles him/her to sue the directors to claim damages. The qualification 'directly affected' by the fraud seems unclear as the fraud committed by the board of director is often against the company and indirectly against the individual shareholders. Anyway, in that case an individual shareholder or groups of shareholders even without the resolution of the required vote can sue the board of directors.

Unlike in Germany the exemption of directors' liability for the 'business judgment rule' is not well echoed in the literatures about the corporate governance in Ethiopia. It is submitted, however, that directors of share companies in Ethiopian do enjoy this legal shield.

[124] Art-365(1) & (2) Com.C
[125] Fekadu, Fekadu Petros, *Ethiopian Company Law*, Addis Ababa University School of Law, 2012 ,p-170
[126] Ibid.

The directors 'external liability' towards creditors is recognized under art-366 of the commercial code. Creditors have the right to sue the board of directors when it 'fails to preserve intact the company's assets' under the above provision. In principle, this happens when the company's assets do not satisfy claims of the creditors. Liabilities of directors under this provision seems a liability without fault (strict liability). As stated above under the internal liability part of the directors, the legal proceedings against the directors cannot be made without the resolution of the shareholders meetings. But, the resolution of the general meeting not to institute proceedings against the board does not affect the creditors' right. Hence, creditors can bring their legal actions notwithstanding the decision by shareholders meetings not to go ahead with the legal action of directors for their internal liability. It is clear from Art-366(2) that the only requirement is the fact that the company's asset is not sufficient to satisfy the claim of the creditors.[127] As discussed elsewhere, in Ethiopian share companies only shareholders qualify to serve as a member of the board of directors. Therefore, the Company law principle that states the liability of shareholders is limited does not seem available to the board of directors in Ethiopian share companies.

3.1.3 Prohibition of Employees Involvement in the Board of Directors

Unlike in Germany, the issue of employee representation in the board of directors has not been a policy relevant to the company laws in Ethiopia. Nowhere in the Ethiopian commercial Code, has the law mentioned about a platform for the employee participation in the corporate governance. The tendency in Ethiopia appears to leave the protection of labor out of the scope of corporate laws. Instead, it is left to the field of employment contract and regulations. As stated above the membership of the board of directors in Ethiopian share companies is reserved

[127] Fekadu, *supra note* no 125, p-162.

for the shareholders only.[128] It impliedly prohibits the firm employees from being members of the board of directors. A shareholder employee perhaps is not disqualified to seat in the board of directors. However, it does not mean employees are represented in the board of directors. The laws governing financial share companies qualify the general rules under the commercial code in many ways. For instance, there is a clear prohibition on the bank employees' placement on the board of directors of any banks.[129] 'Bank employee' includes the chief executive officer and any other worker of a bank involved in the daily business activities of a bank.[130] So, employees are prohibited from being a member to the board of directors of their employer bank as well as any other bank.

No rational mind objects to the protection of employees' interests in firms. But, that does not mean Ethiopia has to necessarily impose the mandatory system of employee codetermination akin to the workers codetermination in Germany. To begin with, the employee expertise in the corporate management in Ethiopia is low. That will in turn complicate the decision making process and install more problems to the relatively young corporate governance practice of the country. Of course, the full participation might not be a policy alternative at the moment as long as employees are sufficiently protected by the labor and employment laws. The trend in Ethiopia considers the issues of employees more of contractual than the subject of corporate governance.

[128] Art-347 Com. C.
[129] Art-5 of 'Limits on Board Remuneration and Number of Employees who sit on a Bank Board Directives No.SBB/49/2011.
[130] Art-2(5) Directives No.SBB/49/2011.

3.2. The General Manager

As the matter of necessity, the general manager controls the day-to-day activities of the company. The general manager is appointed and removed by the board of directors and may not be a member of the board of directors.[131] As it is apparent from Art-348 of the commercial code, the general manager has the status of an employee and may not be a director. The restriction applies for all share companies irrespective of type of their business activities. The justification of the membership restriction of the general manager is to avoid the concentration of powers in the hands of a single person.[132] The plain reading of this provision indicates that an outsider shareholder or non-shareholder may be appointed as the general manager.

Legally speaking, the position of the chair of board of directors and the general manager are not the same. Yet the law makes no clear demarcation of their functions.[133] This may render the relationship between the two unclear or the chair of the board of director assumes the post of general manager as well. In countries with single tier board of directors the clear division of functions between the chairman of the board and the general manager is important. If there is separation of powers between the two, the chairman of the board of directors may be in a position to oversee the functions of the general manager which might be desirable.

Here are some sort of conclusions and remarks before going to the next chapter. Contrast to Germany, Ethiopia does not have a 'two-tier' board structure–it rather adopted a single tier board of directors. The system of appointment of board of directors in Ethiopia is different from the rules under the German Corporate law. In Ethiopia, the first directors are appointed in the statutes of the company and subsequent directors are appointed by the meetings of the

[131] Art-348 Com.C.
[132] Fikadu,*supra note* no 125, p-162.
[133] Hussein, *supra note*, no-103, p-59.

founders.[134] In contrast, the supervisory board in the German stock corporations appoints and dismisses the members of the management board.[135] This approach is entirely unknown to the Ethiopian commercial code.

The differences in board models in these two jurisdictions emanate from the divergences of approaches they follow. As stated elsewhere, Germany follows the 'stake oriented' approach which allows constituencies other than shareholders to take part in the corporate management and supervision.[136] The outcome of this divergence is that Ethiopia tends to follow the 'shareholder value' approach. Consequently, the wealth maximization duty of the directors and managers goes towards shareholders only.

One of the unique features of corporate governance in Ethiopia is that only members of a company qualify for the directorship as per Art-347 of the Commercial Code. This squarely avoids the possibility of including independent/external members in the board of directors. The practice in an advanced legal system such as the US has shown the vital importance of having independent board members. However, the Ethiopian laws do not oblige share companies to have independent directors in their board.[137] This problem needs to be addressed in the future new legislations or amendments to the existing rules.

It is unlikely that the two level model of board of directors like in Germany could work in Ethiopia. A viable alternative notably–introduction of the mandatory independent directors–appears more practical instead of imposing an entirely new board model which is

[134] Art-350 Com.C and Art-321(4) Com.C.
[135] § 84 AktG.
[136] Hackethal, Schmidt and Tyrell, *Corporate Governance in Germany: Transition to a Modern Capital –Market-Based System?* Journal of Institutional and Theoretical Economics, Vol.159.No.4, 2003, p-664.

[137] Hussein, *supra note* no-108, p-184.

likely cumbersome to adopt. Hence, Ethiopia should preferably keep its single tier board model with slight modification of directors' composition and some kind of employee participation than installing an entirely new model of board of directors. It is possible by enacting laws that require share companies to have external directors in their boards.

4. SHAREHOLDERS MEETINGS AND THE PROTECTION OF MINORITY SHAREHOLDERS

As mentioned under earlier chapters, shareholders' meeting is the third mandatory organ of corporate governance besides the management board and the supervisory board in Germany. Likewise, it is the third most important organ of management besides the board of directors and auditors in Ethiopian share companies. Shareholders have the right to participate in corporate decisions in almost all jurisdictions. Yet, the nature of participation, the voting process, the required majority or capital represented varies from jurisdiction to jurisdiction. The shareholders participation are largely provided in the legislations and are enforced through resolutions of shareholders. Both Ethiopia and Germany recognize the principle of 'one share-one-vote'.[138]

If companies have 'influential shareholders' the risk that the minority shareholders investment would be expropriated or abused by the majority shareholders is high. Dominant shareholders' influence is manifested through corporate directors influenced by controlling shareholders. Risks of expropriation of minority shareholders may take different forms such as payment of high salaries to management, appointment of incompetent family member, dilution of voting rights, issuing of shares with multiple votes and improper corporate decisions violating the interest of minority shareholders.[139] The general duties of directors such as 'duty of loyalty', 'duty of care' and disclosure may not be sufficient to safeguard interests of the minority shareholders. Hence there should be additional legal safeguards such, 'preemptive rights', 'commutative voting procedure', 'the right to exit' and 'class and derivative actions'.[140]

[138] Art-407(2) Com.C.
[139] Laporta, Lopez-de-Silanes, Shleifer and Vishny, *Investor Protection and Corporate Governance*, Journal of Financial Economics, Vol-58, 2000, available at: http://leeds-faculty.colorado.edu/bhagat/InvestorProtectionCorporateGovernance.pdf , (last visited March 04/2015), p-4.
[140] OECD Principles of Corporate Governance, 2004, p-42.

This chapter briefly examines the participation of shareholders in the important corporate decisions in Germany and Ethiopia. It also touches upon the legal remedies to safeguard the minority shareholders from oppression by the majority.

4.1. Powers of Shareholders Meetings in Important Corporate Decisions in both Jurisdictions

As outlined under in the previous chapters, the shareholders meeting *(Hauptversammlung*) has no direct say in the appointment and dismissal of management board of the stock corporations in Germany. The influence is only through the appointment of the supervisory board that in turn installs the management board.[141] However, certain key corporate transactions are reserved to the shareholders meetings by the legislations and the articles of association. These decisions include the right of the shareholders to appoint some members of the supervisory board[142], the appropriation of the balance sheet profits[143], the appointment of auditors[144], amendment of the articles of association[145], merger[146], decisions to increase or decrease the 'share capital'[147] or transfer assets of the company.

Unless 'special majority' is stated in the statutes of the company, the German stock corporations require 'simple majority' of the shareholders meeting to pass resolutions at general meetings.[148]However, in Ethiopia the law does not prescribe the general requirement that works for resolutions by the shareholders in general. Rather the majority requirement and the represented capital varies based on the agendum of a resolution. The remarkable difference

[141] Willem J L Calkoen(ed.),*The Corporate Governance Review*, Law Publishing Research LTD,UK,2011,p-129.
[142] §119 (2) AktG.
[143] §119(1) AktG.
[144] §119(1) AktG.
[145] §179(2)AktG.
[146] § 340(2) AktG.
[147] §360 AktG.
[148] §133 AktG.

between the two jurisdictions is that there is no requirement of quorum as such in Germany. However, the Ethiopian law poses different requirements of quorum that should be met based on the nature of shareholders meetings.[149] In Germany, shareholders can attend meetings physically, vote through proxy or use other means such as postal or electronic.[150] The rules governing the participation of shareholders in Ethiopia in principle favors the physical attendance by shareholders though voting through proxy is also allowed. What has not been adopted in Ethiopia yet is voting through the electronic means such as e-mail. It is important to recognize and adopt means that modernize and speed up the voting process by shareholders.

In Ethiopia, shareholders do participate in the corporate governance of their company. In fact, they are called to conduct two types of meetings, i.e. general meetings and special meetings. General meetings are attended by all holders of all shares and conducted to discuss the overall administrative and financial matters of the company. In contrast, special meeting concerns issues such as modifications to the rights of holders of certain class of shares such as preference shareholders.[151] The general meeting of shareholders could be 'ordinary general meeting' or 'extra-ordinary general meetings'. Ordinary general meetings are conducted at least once in a financial year. 'Extraordinary general meetings' are not held regularly, instead it is held only when a matter of particular significance such as amendments of the statutes of the company pops up.

In its regular annual meeting, the shareholders discuss and vote on all issues except those allocated to the 'extra-ordinary general meetings'. It among other things: hear reports of

[149] See, Art-428 Com. C. for quorum to pass resolution at the special meetings, Art-421 Com C.for quorum to pass resolution at ordinary general meetings, and Art-425 Com. C. for quorum to pas resolution at the extra-ordinary general meetings. The majority requirement, which is also the case for Germany, too varies based on the type of meetings under the Ethiopian Commercial Code.

[150] §118 (1) AktG

[151] Art-419 Com. C.

‘balance sheet’, hear the reports of auditors and directors, approve or decline the annual financial statements of the company, discusses how profit(if any) should be distributed, ‘appoint or remove directors and auditors’, fix their salaries.[152]

Unlike ordinary meetings, issues of special importance such as amendments of the statutes of a company are considered at the ‘extraordinary general meetings’.[153] The amendment requires more majority than the ones at the annual meetings: two-third majority.[154] However, the decisions such as change in the national of the company or increase in the shareholders’ investment require the unanimous vote.[155]

The comparative observation of the powers of shareholders meetings in the two jurisdictions reveals that somehow comparable powers are allocated to the shareholders meetings. Features such as shareholders powers to vote on the financial reports of the company presented by auditors and directors are similar. Despite inevitable differences in the required majority both jurisdictions allocate the power to vote on important corporate matters such as the amendment of statutes to the shareholders meetings. Similar observation goes for the power in appointing corporate directors and auditors. Something absent in Ethiopia as figured out repeatedly, is the institution of the board of supervisors. Shareholders in Germany vote for the members of board of supervisors, not the management board. Nevertheless, in Ethiopia the shareholders vote for the board of directors which is the only board in share companies. One of the visible differences between the two is that the Ethiopian commercial code does not recognize the concept of reserving some corporate decisions by the management of the company to the approval of the shareholders meetings.

[152] Art-419 Com. C.
[153] Art-423 Com. C.
[154] Art-425 Com. C.
[155] Art-425Com. C.

4.2. The Protection of Minority Shareholders in both Jurisdictions

There are different legal tools by which the law protects the interests of minority shareholders in publicly owned corporations. Below we will see the typical mechanisms adopted in both jurisdictions. However, it is important to note that the Ethiopian commercial code neither clearly defines ‘minority’ nor explicitly refer to the right of minority shareholders. To comprehend the protections, one has to go through provisions scattered here and there within the title of the code governing share companies

One of the mechanisms adopted in both Germany and Ethiopia is authorizing the minority shareholders to call meetings of shareholders and or enabling them to put certain agendum for resolution at the shareholders meetings. The difference is on the required fraction of share capital the minority shareholders should represent.

Under German Stock Corporation Act, unless lesser minority is stated under the statutes of the corporation, minority shareholders with a capital of one-twentieth can demand the management board in writing to call for the meeting.[156] The right to place the agenda on the already called meetings is also granted under the same rule, yet with different requirement of share capital. This rule authorizes minority shareholders to seek enforcement of their demands before the court of law should the managing board refuses to accept their call. In Ethiopia only the board of directors, the auditors or the liquidators of the company have the right to call shareholders meetings.[157] Yet the law authorizes the court seating at the place of meeting to appoint an officer that can call meetings at the request of minority shareholders holding one tenth of the capital.[158] Minority shareholders utilize this mode of calling general meetings to bring their concerns

[156] §122 AktG.
[157] Art-391 (1) Com.C.
[158] Art-391 (2) Com. C.

before the meetings. In addition, the minority shareholders have the right to put their agenda for consideration before the meetings of shareholders called by the court officer.[159] It is not clear why the Ethiopian lawmaker has granted the court to directly interfere at this stage. It would have been better for the relationships between directors and minority shareholders to allow the later to formally request and see if directors comply with the request. If directors comply with the formal request of minority shareholders, the involvement of court of law might not be important. Yet in this regard, we can conclude minority shareholders are entitled to equivalent protections under both Germany and Ethiopian laws.

The other legal platform to avoid the oppression of minority is the 'right to exit' or withdraw. This right of exit is very important especially in Ethiopia where there is no functioning stock market and shares are illiquid. Otherwise, shareholders cannot find an easy way out from the oppressive majority. Under Ethiopian Commercial Code, the right to withdraw is a basic right that cannot be restricted by the articles of association.[160] It follows from this that the provision in the articles of association that restricts this right is void. If minority shareholders do not want to continue with the company because of significant change in the 'nature and object of the company', 'transfer of the head of the company' they have the right to exit.[161] This forces the company to redeem its shares.

Regarding the derivative suit by the minority shareholders, section 147 of the German Stock Corporation Act authorizes minority shareholders with ten percent or above 'share capital' to demand the company to sue an 'insider' on behalf of their corporation for damages they sustained as a result of oppressive corporate decisions. This rule however does not authorize

[159] Art-391 (2) Com.C.
[160] Ibd.
[161] Art-463 Com.C.

minority shareholders to pursue the claim themselves on behalf of their corporation.[162] There is also a possibility for the minority shareholders to lodge an appeal against the decision passed by the general meeting of shareholders.[163]

A position similar to German approach above is taken in Ethiopia concerning the prohibition of individual shareholder to pursue legal proceedings against directors on behalf of the company. As indicated under the section dealing with the personal liabilities of the directors in Ethiopian share companies, neither individual shareholders nor minority shareholders as a group can bring a derivative suit.[164] The suit is instituted only when shareholders' meeting passes a resolution to that effect. Nevertheless, if the shareholders representing one fifth of the capital opposes the resolution no legal proceeding will be instituted. If the company is not willing to institute a case against the directors within three months after the resolution is passed, the law authorizes the section of the shareholder who supported the resolution to jointly bring an action against the concerned director/s. These laws show that the derivative suit right of an individual shareholder or minority shareholders as a group is not recognized in Ethiopia. Although it may seem rational to prohibit individual shareholder from instituting legal proceedings against directors, it is fair to recognize minority shareholders representing some portion of a company’s capital to bring a legal suit on the clearly defined ‘sufficient grounds’ in the legislations. Besides, there is no equivalent legal norm enabling minority shareholders to lodge an appeal against the decision passed by the general meeting of shareholders in Ethiopia.

[162] Matthias W.Stecher, *Protection of Minority Shareholders in Germany*, In: Matthias W.Stecher (ed.), *Protection of Minority Shareholders*, Kluwer Law International, London, 1997, p-94.
[163] § 243 AktG.
[164] Art-365 Com.C.

In Ethiopia, it is possible for the minority shareholders holding less than 20% of the capital to select an auditor.[165] The parallel rule under German Stock Corporation Act does not empower minority shareholders to select an auditor directly. It instead authorizes the minority shareholders holding 'one-tenth of the capital' to formally request the court for an appointment of 'special auditor'. [166] Contrast to the selection of an auditor by minority shareholders in Ethiopia, in Germany an auditor appointed at the request of minority shareholders inspects the specific alleged financial misconduct or infringement of law committed by the management. It is not an auditor with a complete power to inspect the overall financial records of a firm. No such limitation is stated in the Ethiopian commercial code. Absent that restriction, it is reasonable to presume that an auditor selected by the minority shareholders functions a full-fledged task of examination and authentication.

Under the Ethiopian commercial code, the minority shareholders can also appoint a representative in the board of directors.[167] The literal reading of this legal norm creates a thought that it is providing the 'cumulative voting' system to enable the representation of minority in the board of directors. Nevertheless, few shortcomings of this rule hamper its implementation. First, it obliges a company to provide proportional representation in its articles of association for 'shareholders with different legal status'. It is ambiguous what the expression is referring. No detail rules are available to enforce this right of the minority shareholders and no practice comparable to this rule has been developed so far. Hence, application of this rule absent any expounding court decision or legislation is hard.

[165] Art-368(2)Com.C.
[166] §142 AktG.
[167] Art-352 Com.C.

The legal rules prohibiting directors from contracting with their company without authorization from the board of directors and announcement to auditors also protect the rights of minority shareholders. Under the commercial code, this prohibition of 'self-dealing' appears to be restricted only to the members of the board of directors.[168] As mentioned in the preceding chapter the daily actions of the corporation is managed by the general manager who may not be a member of the board in accordance with Art-348 of the commercial code. In fact, this creates a legal gap unfavorable to minority shareholders. I hope that it will be addressed in the upcoming revision to the Commercial code.

As a conclusion, in both Germany and Ethiopia shareholders meetings serve as one of the organ of corporate governance. It has the right to participate in the key corporate decisions such as alterations to the corporate statutes, changes in the form of corporation, increase or decrease in the capital of a company and mergers. Still there are divergences in the preponderance and the procedure of initiating meetings and setting agenda for resolution. Regarding the protection of the minority shareholder neither the German law nor Ethiopian, provide the 'derivative suit' for the minority to enforce their rights. The rules providing for the representation of minority in the board of directors in Ethiopian share companies are provided in unclear style that made its implementation difficult. Thus, as this right is very important to minority shareholders clear rules and procedures of enforcement need to be provided.

[168] Art-356 & 357. Com.C.

5. AUDITORS

'Transparency and disclosure' of the financial condition of companies is another vital aspect of corporate governance. Disclosures in the form of auditing reports enable investors to know if the management succeeded in realizing the corporation's goal or if there were 'management errors'.[169] Examination of the financial records of companies guarantees that the management is using investors' money for the benefit of the corporation. Auditing is done largely by the external auditors or accounting firms. If a company puts a genuine account of its financial records, it could gain the confidence of its stakeholders and future investors. An Auditor does two principal functions: it guarantees the accuracy of reports by the management and it assesses and reports the overall economic condition of the corporation.[170] By so doing, it protects company against imprudent or fraudulent management.[171] This chapter briefly examines the roles of auditors in the governances of public companies in Germany and Ethiopia.

5.1. Germany

Conducting auditing is compulsory for German stock corporations.[172] Very often, it is carried out by a licensed accounting firms.. In principle, auditor of a stock corporation is elected by the shareholders meetings and assigned by the management board.[173] However, it is the board of supervisors that appoints external auditors, negotiate the fees thereof and seek approval of

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169 Jorg Baetge and Stefan Thiele, *Disclosure and Auditing as Affecting Corporate Governance*, In: Hopt,Kanda,Roe, Pregge, *Comparative Corporate Governance-The State Of The Art And Emerging Research* Oxford University Press, UK,1998,p-722.
170 Ibid, p-736.
171 Plessis, McConvill et al. *Principles of Contemporary Corporate Governance*, Cambridge University Press, New York, 2005, p-239.
172 § 316 AktG and § 267 Commercial Code of Germany.
173 Peter -J. Schmidt, *Disclosure and Auditing : A German Auditors Perspective*, In: Hopt,Kanda,Roe, Pregge, *Comparative Corporate Governance-The State of the Art and Emerging Research,* Oxford University Press, UK,1998,p-749(see also § 119(1) AktG and § 127 AktG).

shareholders meeting.[174] Subsequent to approval by the meeting of shareholders, the board of supervisors concludes a contract of service with the appointed auditor/s.[175] As per the principle of freedom of contract, the contents of the service contract between company and external auditors are determined through negotiations. So do the respective rights and duties of the parties. Still auditors have the statutory duties imposed by the laws. The breach of these duties will entail liability of the involved auditor/s.

The German Code of Corporate Governance requires the board of supervisors to create different committees to effectively carry out its task of overseeing the board of managers. The 'compensation committee' and the 'audit committee' are amongst few of the possible committees that could be set up by the board of supervisors. The 'audit committee' has to work hand-in-hand with the external auditor.[176] Still as mentioned earlier, German Code of Corporate Governance is the compilations of recommendations and 'good practices' that are not binding. Consequently, it is up to a corporation to set up the 'audit committee' or otherwise.[177]

Normally the duty of keeping financial records of a firm belongs to its managers, directors and internal auditors. Thus, the external auditors do not prepare these financial documents. What they do is detecting mistakes or misconducts made by those who actually kept the documents and ensuring its authenticity. The auditors verify and state declaration of their opinion on the correctness of the report by the management.[178] They give report on the overall financial

[174] §111(2) AktG.
[175] §111(2) AktG.
[176]Dennis Voeller Michael Bremert, Nicole Zein, *Interdependence between Auditing and Corporate Governance: Evidence from Germany*, 2013, available at: http://www.sbr-online.de/pdfarchive/einzelne_pdf/sbr_2013_july_198-226.pdf, (last visited on March 22, 2015), p-201.
[177] Ibid.
[178]Baetge & Thiele, *supra note* no 169,p-737.

condition of the corporation to the supervisory board to give it ‘an early warning’ of the possible crisis.[179]

Auditors should maintain its maximum autonomy from the management (internal directors) so that their reports would be trusted by the shareholders.[180] In Germany, it is required that auditors should be closer to the board of supervisors or the audit committee.[181] The auditor submits its report to the management board which forwards it to the supervisory board.[182] In fact, there is no legal requirement for the actual presence of auditor at the discussion of annual meeting on the annual financial reports.[183]Auditor makes an opinion without further explanation on the financial statements in general.[184]

5.2. Ethiopia

Auditors are the third organ of corporate governance under Ethiopian commercial code. In principle, auditors are appointed by the general meetings of shareholders in accordance with Art-368 of the commercial code. This rule allows a natural person or an accounting firm to be appointed as an external auditor. Practically speaking, the shareholders meeting may not be in a position to appoint auditors and involvement of the board of directors is unavoidable. Very often, the board of directors recommends auditors or accounting firms and asks for approval of the shareholders meetings.[185] Yet in some share companies, shareholders meetings delegate its power of appointment to the board of directors.[186] Though it simplifies the process of appointment, the practice of delegating the power of appointment to the board of directors may

[179] Baetge & Thiele, *supra note* no 169,p-738.
[180] Ibid..
[181] Baetge & Thiele, *supra note* no 169, p-737.
[182] Schmidt, *supra note* no 172, p-750.
[183] Ibid.
[184] §322(1) German Commercial Code.
[185] Fekadu, *supra note* no 125, p-178
[186] Ibid.

affect the auditor's independence.[187] Hence, clear laws should be enacted to balance the independence of the auditors from influence of the board of directors. Care should be taken not to totally take away the shareholders vote in the appointment of the auditors.

In carrying out their auditing tasks, auditors should avoid any conflict of interests and maintain their autonomy. The law purports to avoid the potential conflict of interests from the very outset by disqualifying certain persons from being appointed as auditors. Founders of a company, shareholders who contributed in kind, directors, and persons affiliated with or who receive regular salaries from the listed persons in relation to duties other than auditorship cannot serve as auditors.[188] The relationship between the auditors and any of the persons listed above may daunt auditors from genuinely doing their jobs. Auditors may tend to cover up the financial flaws committed by directors. That is why in many jurisdictions auditors have to sign the declaration of independence before commencing their tasks.

The general meeting of shareholders is entrusted with the power of dismissing and determining the salaries of auditors.[189] Reserving the power to dismiss to the shareholders again helps to avoid the directors from dismissing an auditor for fear of the potential exposure of their financial misconducts and possible criminal acts. As to the determination of the salary, the laws do not seem to take into account the fact that the payment for the service of auditors depends on the negotiation and a covenant of service concluded with the company. It may not be solely decided by the shareholders meetings.

Above we have stated the fact that the accuracy of the financial records is indispensable for the governance of companies. Auditors are civilly and or criminally liable for intentionally

[187] Ibid.
[188] Art-370 Com.C
[189] Art,371,372, 368 Com.C

furnishing and confirming the false financial records of a company.[190] Failure to disclose the misconducts of management and board of directors to the prosecution entails liabilities as well.[191]

In conclusion, it is mandatory for public companies to audit their financial records in both Germany and Ethiopia. Auditors should maintain their autonomy from the management and the board of directors in both jurisdictions. One thing which the Ethiopian Commercial Code does not require share companies to have is the audit committee which is in a position to be involved in the process of selection of auditors as well as thereafter.

[190] Art-368 Com.C
[191] Art- 368 Com.C

CONCLUSION

Ethiopia has had transplanted its commercial laws largely from the continental European legal codes in 1950s and 1960s. Due to the lack of locally grown business tradition capable of implementing the transplanted rules, the penetration of the rules of the commercial codes has remained low until recently. This was partly attributable to the hostile changes of regimes in Ethiopia.

It rather took a country longer to see the growth of corporations. When the socialist system was introduced following the downfall of the monarchical system in 1974, companies formed following the introduction of new laws were nationalized and the Commercial Code was thrown out of use. It was reintroduced following the downfall of the socialist system in 1991.

The new government promised to establish a market economy and the Commercial Code was reintroduced. In fact, many private limited companies were formed following the new economic system. Still the formation of new large share companies was still to come. Only few share companies were formed in the late 1990's. It was only after 2000 that the country has seen the formation of more share companies. Yet the expertise and confidence in running the advanced form of businesses in the form of share companies is minimal. The country's capital market is less developed than most of the African countries themselves. The concept of the stock exchange is non-existent and in most cases, the shares are available only to the nationals. Foreign financial institutions cannot operate in the countries capital market. The country has a grip control over the corporate governance of the financial institutions. There are alleged cases of malpractices in the corporate governance in the country. Corporate transparency and corporate disclosure are not reputable. No doubt, the corporate governance reform is required in the country.

Cognizant of the fact that the available rules on corporate governance are short of realizing the ultimate goal of corporate governance in the 21st century, the Ethiopian government is in the process of revising the Commercial Code. It is inevitable in the process of revision to look at rules of advanced economies. Germany is one of the potential jurisdictions to consider.

Contrast to the two level board model in German stock corporations, share companies in Ethiopia adopt a single tier board of directors. The two level boards of directors in Germany have its own historical reasons such as the relationship between labor and management. This resulted in the stronger recognition and participation of labor in the governance of corporations. As the approach of corporate governance in Germany is the 'stake holder' model, stakeholders other than shareholders do participate in the governance of their companies. The 'stakeholder' approach is not favored in Ethiopia. It is rather, more of 'shareholder value' approach. This is reflected in many ways. First of all the commercial code allows only shareholders to serve as members of the board of directors. Secondly, it prohibits the company workers to seat on the board of directors. Thirdly, there is no possibility where by other role players such as creditors could seat on the board of directors.

The questions is what can Ethiopia possibly borrow from Germany as far as the board model and structure is concerned. The writer is of the opinion that the country should retain its single tier board of structure with the introduction of mandatory non-executive members and possibly some sort of employee representation instead of adopting the full-fledged 'two-tier' structure like that of Germany. Some of the reasons the country should retain its single level board structure is the model has been there for relatively longer and practically tested. Thus, the business can easily adapt to a slight modification. The introduction of an entirely new board structure is less likely to receive a smooth implementation. Besides, the single tier structure of board of directors has also proved viable in many reputable jurisdictions. It suffices to mention the US system.

As the expertise of employees in deciding upon the corporate affairs is low, it may not be important to advocate a full workers participation in the corporate governance. Still the country has to recognize the involvement of employees in the corporate decisions. It does not have to be a full-fledged system of workers codetermination akin to the system in German stock corporations. The current rules in the country prohibit workers from seating on the board of directors of their own company. There is no clear rational for having this sort of laws

Regarding the personal liabilities of the directors towards the company and the third parties, the country needs to recognize the Germany's ‘business judgment rule’ exception. This rule among other things encourages managers to confidently make business decisions they believe in good faith to be worthy for the company without any fear of the legal proceeding against them. In addition, the commercial code needs to recognize the autonomy of the board of directors from the general manager on one hand and separate the positions of the chair of the board of directors and the general manager. It is risky when the general manager position is controlled by the same person who chairs the board of directors. This practice concentrates powers on the hands of a person as he is in superior position and better information than others. The possibility of manipulation is high.

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