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Mezgebu Abye Zewudu
Mizan-Tepi University

ABSTRACT

The main purpose of this paper is to analyze whether the government intervention plays a great role or not in the functions of corporations in Ethiopia. The controversy regarding the operation and effect of government intervention in the economy has not yet been conclusively resolved despite efforts of different scholars in different countries. In Ethiopia, it has been subject to different arguments as well. Even if there are different arguments regarding the intervention of the government in the economy particularly in the functions of corporations, still the government has continued to participate highly in the economy. The functions of corporations need to be reconsidered when the issue of government intervention arises in the economy. Due to this, it is better to save corporations not to be affected by intervention of government.

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The Impact of Government Intervention on Corporate Functions: The Case of Ethiopia

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I. ABSTRACT

The main purpose of this paper is to analyze whether the government intervention plays a great role or not in the functions of corporations in Ethiopia. The controversy regarding the operation and effect of government intervention in the economy has not yet been conclusively resolved despite efforts of different scholars in different countries. In Ethiopia, it has been subject to different arguments as well. Even if there are different arguments regarding the intervention of the government in the economy particularly in the functions of corporations, still the government has continued to participate highly in the economy. The functions of corporations need to be reconsidered when the issue of government intervention arises in the economy. Due to this, it is better to save corporations not to be affected by intervention of government.

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Author: Assistant lecturer, LL.B University of Gondar, LL.M Candidate in Business and Corporate Law, Bahirdar University; Mizan-Tepi University, Ethiopia.

II. INTRODUCTION

The presence of state in the economy and market has passed through its own history path. Initially, the primary role of the state was maintaining peace and order and protecting the country from external aggression¹. But gradually, the state

assumes beyond this traditional role and starts to involve in economic activities. Such kind of involvement of the government in the market or economy imposes impact on competition of private corporations in the market. In history of corporations, they were relatively insignificant before one hundred and fifty years ago. But today, they are vivid, dramatic and pervasive presence in our lives. Corporations have their own rights, privileges, and liabilities distinct from those of its members or individual owners. There are different types of corporations, most of which are used to conduct business. With regard to regulation of corporations or companies, the government-created regulatory and legal environment has a substantial impact on time horizons of companies, but the impact is complex and multidimensional; some regulations and legal procedures can lengthen corporate time horizons, while other regulations, or legal constraints that introduce substantial unpredictability, can shorten time horizons. Government procurement and regulatory policies have clearly provided initial and sometimes large markets for a host of products that we think of as "commercial today. The activities of the government may affect the interest of the private corporations in its policy or legal constraints².

In particular, Ethiopian public enterprises are also affecting the healthy competition. The government provides some exclusive privileges to public enterprises. This affects the economic security of private firms competing with the same sector. The government owned enterprises which

¹ P. A. Toninelli, *The Rise and Fall of State-Owned Enterprise in the Western World* (Cambridge University Press 2000) in OCED 'State Owned Enterprises and Competition Neutrality' (2009)9 <<https://www.oecd.org/>

competition/competitive-neutralityBanks>accessed December 19, 2017

² Ibid

participate in the market. The government in such kinds of activities may intervene in the functions of corporations negatively.

Having this, we will see in this paper, the concept and meaning of corporations, and the corporate functions and responsibilities, the impact of government intervention on corporate functions and finally we will have conclusion and recommendation

III. THE CONCEPT AND MEANING OF CORPORATION

The word "corporation" derives from *corpus*, the Latin word for body, or a "body of people". By the time of Justinian (reigned 527–565), Roman law recognized a range of corporate entities under the names *universities*, *corpus* or *collegium*. These included the state itself (the *Populus Romanus*), municipalities, and such private associations as sponsors of a religious cult, burial clubs, political groups, and guilds of craftsmen or traders³.

Entities which carried on business and were the subjects of legal rights were found in ancient Rome, and the Maurya Empire in ancient India. In medieval Europe, churches became incorporated, as did local governments, such as the Pope and the City of London Corporation. The point was that the incorporation would survive longer than the lives of any particular member, existing in perpetuity

Having this as initial information for its historical point of view, a corporation is a business or organization formed by a group of people, and it has rights and liabilities separate from those of the individuals involved. It may be a nonprofit organization engaged in activities for the public good; a municipal corporation, such as a city or town; or a private corporation (the subject of this article), which has been organized to make a profit. In the eyes of the law, a corporation has many of the same rights and responsibilities as a person. It may buy, sell, and own property; enter

³ Ibid

into leases and contracts; and bring lawsuits. It pays taxes. It can be prosecuted and punished (often with fines) if it violates the law. The chief advantages are that it can exist indefinitely, beyond the lifetime of any one member or founder, and that it offers its owners the protection of limited personal liability.

Registered corporations have legal personality and are owned by shareholders whose liability is generally limited to their investment. Shareholders do not typically actively manage a corporation; shareholders instead elect or appoint a board of directors to control the corporation in a fiduciary capacity. In most circumstances, a shareholder may also serve as a director or officer of a corporation.

IV. FUNCTIONS AND RESPONSIBILITIES OF CORPORATION

To understand the role that the corporation plays in modern society, we must first understand the unique functions of the corporation and what value it provides others. Corporations take on many of the more basic tasks of organizations today. The corporation as an organizational structure facilitates more than you might think of the everyday things you take for granted. The goods you consume and the work you do to earn them are tied to corporations⁴.

4.1 Increasing profits

Corporations are in business to earn a profit. However, corporations are also responsible for increasing profit to maximize those of their shareholders. The shareholders have ownership in a corporation. They earn profits on their initial and additional investments. These earnings are called "earning per share". Corporations maximize these earnings of shareholders by selling more products⁵ to customers.

⁴ *Corporate Functions*, by Casey Reader; Updated September 26, 2017p21

⁵ *Functions & Responsibilities of a Corporation* by Rick Suttle

4.2 Social responsibilities

Corporations are also responsible for giving back to their communities. They may also give protection for the communities where they are established such as protection for communities' health, environmental issues, human rights⁶ or they may be responsible to conduct their activities without affecting the interest of the society.

4.3 Managing resources effectively

A corporation is responsible for managing its resources effectively. Those corporations which are involved in manufacturing must procure the necessary raw materials to create products. The objective of most corporations is to minimize waste⁷ through managing the resources of the corporation effectively. This is also true for other corporations that are involved in different business activities.

4.4 Providing continuity

Corporations are formed to stay in business on a permanent basis. Therefore another corporate function is continuity of business. This is essentially means that a corporation must continue to function when people are fired, leave the company or pass away⁷

In addition to the above ones, corporations may also have other functions such as deposit or saving, loan particularly financial corporations like banks, creation of many jobs for people who are seeking to be employed, produce innovative products and services that affect every aspect of daily life and generate economic prosperity for employment and shareholders

4.5 The impact of government intervention on corporate functions in Ethiopia

Over the centuries, economists and politicians have debated the proper role of government in relation to the private economy. Thousands of

academics have attempted to determine the most efficient means by which governments can influence the activity of private businesses and consumers. State-led efforts to shape or control business activities have played a central role in the development of public institutions, political ideologies and business strategies. There remains much disagreement about whether government-led intervention in the economy should be permissible⁸. The relationship between government and business can be complicated at times, as businesses and governments often have conflicting agendas and priorities. Nevertheless, government regulation is a fact of life in any industry, and businesses that learn to work with rather than against government authorities can save themselves a good deal of time and effort dealing with fines and other legal issues⁹.

When we come to Ethiopia, Ethiopia experienced different forms of government intervention in the last three regimes. During the Monarch period between 1941 and 1974, mixed economic policy was implemented with more government intervention in manufacturing sector and services sectors. During the military period between 1974 and 1991, the government used the command economic system with full control of the economy. Such government intervention during the military government reduced economic growth and development in the country. During the reform period between 1991 and 2002, Government of Ethiopia has implemented Structural Adjustment Program (SAP) with minimal government intervention. During this reform period the country achieved irregular/unstable economic growth and slow social development¹⁰.

¹¹ While Ethiopia offers a number of opportunities, the market is also riddled with challenges. The

⁸ James Hirby, James Hirby, what are the pros and cons of government intervention in the economy? <<<http://plus.google.com/u/o/>>> access at Janu 1, 2018

⁹ David Ingram, Government Regulation Factors in Business and online at Business.com

¹⁰ Dr. Teshome Adugna, Government Interventions, Economic Growth and Development in Ethiopia

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⁶ Ibid

⁷ Ibid

government is engaged in a slow process of economic reform and liberalization, and the state remains heavily involved in most economic sectors. The Government of Ethiopia (GOE) retains control over the utilities sector, such as telecommunications, internet and prohibits foreign ownership of banking, insurance, and financial services. State-owned enterprises (SOEs) dominate the economic landscape, reducing room for the private sector to flourish. SOEs actively encourage joint venture and equity partnerships with foreign companies¹².

4.6 The impact of blocking internet and mobile telephone on corporate functions

The government has a monopoly power over the internet, telecom sector, and obstructive telecom policies have notably hindered the growth of information and communication technologies (ICTs) in the country. Despite low access, the government maintains a strict system of controls over digital media, making Ethiopia the only country in Sub-Saharan Africa to implement nationwide internet filtering. Such a system is made possible by the state's monopoly over the country only telecom company, Ethio-Telecom, which returned to government control after a two-year management contract with France Telecom expired in December 2012. In addition, the government's implementation of deep-packet inspection technology for censorship was indicated when the network, which helps people communicate anonymously online, was blocked in mid-2012. The Ethiopian Telecommunications Agency (ETA) is the primary regulatory body overseeing the telecommunications sector. Although it was established as an autonomous federal agency, in practice, the ETA is tightly controlled by the government. In addition, the space for independent initiatives, entrepreneurial or otherwise, is extremely limited. In 2011, the government began granting permission to private companies that run internet-dependent

operations. Connections previously reserved for governmental and international organizations per special authorization. Under the new directive, private companies are supposedly permitted to use the technology for their own operations, but bureaucratic red tape significantly hinders the service. Moreover, the directive does not allow companies to provide services to third parties, enabling Ethio-Telecom to maintain its monopoly on public internet access¹³. The government of Ethiopia has blocked internet websites and mobile phone communications to tighten political sensitive events in different times such as 2016/17, particularly internet blocking in 2017/18. The government blocked the entire website rather than blocking selecting websites. Such kind of measure hinders the corporations not to run their activities in a good manner. One or in another way, the functions of corporations are supported with the services of internet and mobile phone communications. When such services are blocked, the corporations may face different problems such as they may be unable to provide and accept information to/from concerned bodies respectively. If mobile phone communication is blocked, the employees of the corporations may be unable to exchange information to run their activities and they may be forced to walk on foot to deliver or receive information to the concerned bodies like what the previous generation did it in the first century. The customers of such corporations may also be unable to get information through these service systems. Now a day these service systems play a great role in any business transactions. Exchange of information through internet and mobile phone communication gives power for corporations to transact their business in line with the concept profit and economic development of a country as well. Hence blocking such service system means that it is against the 1995 FDRE constitution of the right to receive and impart information and ideas of all kind through any media of his choice¹⁴

¹² <https://www.export.gov/Ethiopia> - Market Challenges access at 18/2017, p 10

¹³ << <https://stats.oecd.org/glossary/detail.asp?ID=964> >>

¹⁴ see Art.29 Constitution of the Federal Democratic Republic of Ethiopia, 1995,

as stated under Article 29. The government owns Ethio- Telecom Corporation exclusively and creates problems on other corporations by blocking internet and mobile phone communications in against of this constitution. Therefore the government has intervened indirectly on corporate functions through such activities, and it has a negative impact on their functions.

4.7 The impact of government intervention on the function of financial corporations

Financial corporations consist of all resident corporations or quasi-corporations principally engaged in financial intermediation or in auxiliary financial activities which are closely related to financial intermediation source¹⁴. Having this concept, Ethiopia has adopted a free market economy policy. The adoption of the free market principle in the country justifies no state ownership of the financial corporations. Government ownership is meaningless when it harms competition through market dominance, allows political interference in the operation of the financial institutions, puts the government in conflict of interest as owner and regulator of the financial businesses, and sustains under-performing government institutions (as this has been true in both Ethiopia and the many other developing countries¹⁵ (from Dr. Solomon page 119) Ethiopia's financial system is small and largely dominated by the state. Currently public banks account for 67% of total deposits and 55% of loans and advances. Government dominates lending, controls interest rates, and owns the largest bank, the Commercial Bank of Ethiopia (CBE) whose assets represent about 70 percent of the sector total, as of April 2012. The Central Bank, the National Bank of Ethiopia, has a monopoly on all foreign exchange transactions and supervises all foreign exchange payments and remittances¹⁶. CBE has expanded its branches

throughout the country in rapid manner in relation to private banks in Ethiopia. Such expansions of branches of commercial banks of Ethiopia may bring the private banks uncompetitive and out of the game in business transactions. The rapid expansion of this bank may impact negatively the private banks in control of customers and good working areas. Due to this they may remain restrictively in specified areas. In addition to this, the government paid salaries of all civil servants through Commercial Bank of Ethiopia. This makes the civil servants by default to be the customer of the commercial bank of Ethiopia. This may help the bank to maximize its profit but private banks have no the opportunity to attain profit from the deposit of such persons.

NBE has given the power to regulate any banking activities in Ethiopia. However this bank is accountable to the Prime Minister of FDRE¹⁷ as per Art.4 of NBE establishment pro.591/2008.

At this provision we can infer that NBE is accountable to the political authoritative organ and hence it will become politically influenced body. This may make the NBE not to be independent to run its own activities and may set difficulties not regulate equally the state and private owned financial corporations. This indirectly may a negative impact on particularly on private financial corporations. In addition to this, in particular, NBE has the power to collect any information from any banks in Ethiopia as per Art.28 (4) of Banking Business Pro.592/2008. However, they are also forced to disclose their piece of information to the body to which NBE is accountable as per Art. 28(4) (d) of this proclamation. This body is the FDRE prime minister and this provision highly opens the way for the intervention of the government as well as this may erodes the freedoms of private financial corporations, not to perform their activities in full

¹⁵ Financial market development, policy and regulation: the international experience and Ethiopia's need for further reform by Dr. Solomon Abay Yimer, p119

¹⁶ see the National Bank of Ethiopia Establishment proclamation No. 591/2008, Art.4

¹⁷ See the Banking Business proclamation No.592/2008, Art. 28 (4)

of confidence. This will highly impact their functions.

V. MIX POLITICS WITH BUSINESS

In Ethiopia, the active involvement of political parties in business through endowment companies, which were originally intended to conduct non-trade development activities, creates a gloomy condition for the growth of the private sector since party affiliated companies enjoy competitive advantages over private companies. The absence of an organized and well-regulated share market makes valuation and price discovery of banks problematic and thereby inhibits share markets from being sound corporate governance mechanisms. The existence of endowment companies owned and controlled by political parties is one of the controversial aspects of the investment climate in Ethiopia. Endowment companies are allowed to own enterprises that compete with the private sector, although it is unclear how the initial capital of these companies was paid. To date these companies are presented as if they are regional development organizations and each federal region is supposed to have at least one endowment company holding various enterprises that operate factories, banks, insurance companies, and other business activities¹⁸. At present, there are four endowments under the umbrella of the EPRDF. These are: EFFORT (for the rehabilitation of Tigray region), Endeavour (for rehabilitation of Amhara region), Dinsho (focused on rehabilitation of Oromia Region), and Wondo-Trading (for rehabilitation of Southern region). EFFORT (The Endowment Fund for the Rehabilitation of Tigray) is a multi-billion dollars business conglomerate, which holds over eighty portfolio companies under it. These companies are highly involved in business transactions today. Given the blending of politics and business, it is highly probable that business decisions are being made solely on

political justification rather than sound business principles. Hence, in the absence of a conducive and reliable business environment, the growth of the private sector based on competition and vigorous market principles is futile¹⁹. In doing so, such presence of government intervention in the economy particularly on the functions of corporations may lead to the private corporations as accompany of the government when it performs its functions in the market. The private corporations may used as a tool of expedient of the government rather than competing in the market.

5.1 The impact of intervention by government on corporations functions through Tax Law

In principle tax law is a very important instrument for the government to collect revenue from tax payers. Even if it is a very important instrument, the government needs to make its tax laws or regimes non-discriminatory and contributory the economic development of the country. Hence, tax payers are duty bound to pay tax to the government. Corporations are also not exceptions to this obligation. They should pay tax as long as they are participated in tax attractive areas. Regarding this concept, the tax regime or law of Ethiopia, particularly according to the income tax proclamation¹⁹, as per Arts.14 (1) and 19(1), it imposes tax on bodies/corporations 30% flat rate tax irrespective of their income level and time of establishment. A person who works in a day and a person who works for a long period of time may not have equal income i.e. time play a great role to accumulate high amount of income. So they will have different income. Hence, this proclamation creates discriminatory on corporations. Because, it tries to treat unequal corporations equally. i.e.it imposes 30% flat rate tax on corporations for different income earners. This may discourage the corporations that have less income and newly established ones. Because

¹⁸ Ayele, Faculty list Electronic Law Journals Law Social Justice and Global Development Journal LGD Issue 2013 (1), p12

¹⁹ see Arts.14 (1) and 19(1), the enacted Federal Income newly Tax pro. No. 979/2016, Addis Ababa, 2016, 22nd year, No 104

they may be unable to pay tax and compete with strong corporations in the market. In the presence of such tax rate imposition of tax, they may not achieve their objectives in the market. On the basis of this fact; they may prefer to be out of the market in order to escape from loss. So, the government has intervened in functions of corporations by making the law strict and discriminatory among corporations regarding the obligation of tax payment. But as we have noticed from different provisions of the income tax proclamation, persons other than bodies or corporations, pay tax according to their income level. Their income level is determined in the form of schedules but not the corporations' income.

Therefore, imposing tax on low income earner corporations may be considered as prohibiting them not work in the area and this affects their function and interest, but not only their interests but also the interest of the country not to be flourished in economy

VI. CONCLUSION AND RECOMMENDATION

6.1 Conclusion

This paper has attempted to consider the overall climate of government intervention and its impact on corporate functions. The issue of government intervention directly or indirectly on corporate functions remains the major problems in Ethiopia. The government of Ethiopia is the exclusive owner of Telecom corporations and due to this, it has intervened on the functions of corporations indirectly by blocking internet and mobile phone communications. Such actions of the government may create problems or obstacles for corporations not to run their activities in a good manner. Because one or in another way, most corporate perform their functions in support of internet and mobile phone communications.

Ethiopia has adopted free economic policy, but the government of Ethiopia has intervened in the economy and highly influenced the functions of corporations. The government dominates the

private corporation by owning financial corporations like CBE and other corporations. Owning such corporations in the market by the government has a negative implication on the function of private corporations. Because they may be unable to compete equally with the state owned corporations.

Corporations may also be influenced by political authorities because the top regulator of financial systems of Ethiopia is accountable to the prime minister of Ethiopia. This may affect the freedom of corporations not to perform their activities in a good manner.

In Ethiopia, the active involvement of political parties in business through endowment companies, which were originally intended to conduct non-trade development activities, creates a gloomy condition for the growth of the private sector since party affiliated companies enjoy competitive advantages over private companies. At present, there are four endowments under the umbrella of the EPRDF. These are: EFFORT (for the rehabilitation of Tigray region), Endeavour (for rehabilitation of Amhara region), Dinsho (focused on rehabilitation of Oromia Region), and Wondo-Trading (for rehabilitation of Southern region). EFFORT (The Endowment Fund for the Rehabilitation of Tigray) is a multi-billion dollars business conglomerate, which holds over eighty portfolio companies under it. These companies are highly involved in business transactions today and they affected the corporate functions in the market.

The government may also intervene on the functions of corporations through regulations of law like tax law.

Therefore, the government has intervened in different functions of corporations and these interventions have many negative effect or impact on the activities of corporations.

6.2 Recommendations

In this paper I have raised some problems regarding the impact of government intervention

on corporate functions. Such problems may bring the functions of corporations into unhealthy and unstable. Due to this I have given the following recommendations.

- ❖ In our country, Ethiopia, there are redundantly raised problems by the people in the politics sensitive areas, and the government of Ethiopia has blocked internet and mobile phone communications to ban such problems. But it has a great disadvantage for the economy of the country. In my point of view, blocking of internet and mobile phone communication which is done by the government is not an appropriate measure to ban such problems. But it is the way of creating another additional problems rather than giving solution for the problems. It is better the government should search the source of the problems critically and answer the problems accordingly rather than blocking such service systems. It is not only important for the country but also for corporations to use the fruits of technologies in their functions.
- ❖ In order to increase the freedom of corporations in their respective functions, the National Bank of Ethiopia should not be accountable to the FDRE prime minister rather it is better to accountable to the parliament. NBE, the top regulator of financial systems in Ethiopia should not be accountable to the political authoritative organ. It should not be politically influenced organ rather it is better to be independent and free in its operation.
- ❖ As we knew, Ethiopia has adopted free market economic policy. In principle, this policy gives greater opportunity for private corporations to play in the market. But in practice, the government has played greatly in the market in the dominance the private ones. This will make the private corporations out of the game. There must be limitation for the participant of the government in the economy and high opportunities of working environments should be reserved to the private corporations. If the government increases its participation in the economy, the

profitability of private corporations will decrease. i.e. why one of the functions of corporations has got negative impact from the intervention of the government in the economy.

- ❖ Our tax law imposes tax on bodies/corporations at 30% flat rate. But corporations may not be equal in their income level. So, it not fair imposing tax on unequal bodies equally. Therefore our tax law is better to be revised and enacted in the form of having schedules which determine their income level like other tax payers and this helps them to pay according to their abilities. This also helps them to continue in the market and compete with other corporations in the market.

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