International Journal of Research in Finance and Marketing (IJRFM)
Available online at : http://euroasiapub.org/current.php?title=IJRFM
Vol. 6 Issue 12, December - 2016, pp. 46~57
ISSN(o): 2231-5985 | Impact Factor: 5.861 | Thomson Reuters ID: L-5236-2015

Corporate Governance Practice Landscape in Ethiopia: Past, Present and Future

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Abstract

This research paper is carried out on Corporate Governance Practices Landscape in Ethiopia Past, Present and Future. The objective is to investigate the status of corporate governance practices of Ethiopian Share companies. since the corporations' good governance practices is important for attracting the foreign capital flows through investment and it is helpful tool to ensure the promotion of the economic growth and transformation in business sectors. This research paper is focused mostly to give a reflection on corporate governance practices landscapes by taking into account different dimensions of corporate governance that affect the climate of doing healthy corporate business for the purpose article review were carried out; together with this interview and survey were developed by considering commercial codes of Ethiopia, other legislatives and international best practices to be carried out with chief executives officers of selected corporate sectors and government authorities' and survey data were collected from different stakeholders. Based on Qualitative analysis carried out the findings on the landscapes of corporate governance practices indicated rising and falling in past two epochs and we were not in a position to talk about corporate governance practices in the country due to the fact that there was deep rooted problem of ownership that affects corporate governance practice too. And today's epoch there are a lot of changes on the corporate business dealings through privatization of stated owned firms and many share companies are formed through Initial Public Offerings even though changes are made on business dealings the corporate governance system is not effective due to lack of structured corporate governance framework, up to date regulatory framework, national codes and principles as to corporate governance, unavailability of qualified professionals, dearth of corporate governance policy framework all these limitations results problem of transparency and disclosure, distorted governance structure, lack of adequate protection of minorities rights, weak enforcements from the regulatory body at compliance with applicable laws, conflicts of interest etc. With respect to future landscape though it is emerging subject and at grass root level there are a number of good begging's on government authorities', corporate sectors and different stakeholders they

started making institutional framework changes, preparing draft corporate governance codes to incorporate current international best practices and to make awareness creation on the business community all these activities will foster this young and infant subject in the country to sustain and to make healthy the country's economic growth in share business.

Key words: corporate governance, Disclosure and transparency, regulatory and policy framework, investment, foreign capital flows, Ethiopia

1. Background of the Study

Corporate governance, i.e. the system by which companies are directed and controlled, has become a key topic for legislation, practice and academia in all modern industrial states (Klaus J. Hopt, 2011) as well as it has received wide attention in recent years both in practice and in academic research (Brown, 1999; Levitt, 1998; Beasley, Carcello, and Hermanson 1999; DeZoort and Salterio 2001). Significant academic work confirmed strong links between financial development, economic performance, and corporate governance (OECD, 2003). Failure of giant corporate groups in the globe strengthens the demand for good corporate governance further as mentioned by Shil, N. C (2008) in some of such failures, accounting as a discipline is held liable. The Ethiopian Commercial Code of 1960 provides six forms of business organizations, namely: Ordinary Partnership (Arts 227-270), Joint Venture (Arts. 271-279), General Partnership (Arts. 280-295), Limited Partnership (Art. 296-303), Share Company (Arts. 304-509) and Private Limited Company (Arts. 510-543) among those types this paper focuses on share company types only. A share company is a form of business organization where, in most instances, a large group of people invest cash or in-kind contributions in a company (administered by strangers) in return for units of ownership representing a proportion of the company's capital in the form of shares. The share company is one of the forms of business organizations recognized under the Ethiopian Commercial Code. According to Robert W. McGee (2009) corporate governance issues are especially important in developing economies, since these countries do not have a strong, long-established financial institution infrastructure to deal with corporate governance issues. The weakness of corporate governance is perhaps the most important factor blamed for the corporate failure consequences (Saudagaran, 2003). Effective corporate governance structures encourage companies to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved (ASX, 2007). An effective system of governance should help ensure compliance with applicable laws and regulations, and further, allow companies to avoid costly litigation (IFC, 2004). OECD (2003) expressed also that the experience of economic transition in developing and emerging market economies have reasserted that a week institutional framework for corporate governance is incompatible with sustainable financial market development.

The research gap identified in the world immediate pressures on policy arise from corporate scandals and large failures; financial market developments and the objectives to promote growth are focusing attention on corporate governance (OECD, 2004). Nevertheless, Center for Corporate Governance (2012) pointed out that the world second largest and second most populous continent, Africa, situated within the broader political and macro-economic governance landscape. Occupying about six percent of the world surface area and home to a great bulk of natural resources, Africa still has the highest proportion of poor people in the world and the region has not escaped the adverse effects of the global economic crisis due to the importance of international trade, foreign capital inflows, development assistance and Diaspora contributions to national economies. The main challenges facing corporate governance in Africa include good economic governance, a legal and regulatory framework for corporate governance, strong supervisory institutions with enforcement powers, a capacity for self-monitoring of compliance, a strong and a well-balanced board of directors, timely and accurate disclosure of information, and corporate social responsibility (African Development Report, 2011). In addition, the literature on Africa is still very thin or infant although scholars in the developed economies have developed a large body of literature on the subject. These are the major challenges of Ethiopian share companies governance as one of sub-sharan African country together with this research paper identified absence of national up to date codes and corporate governance principles, regulatory framework for share companies operating today which is incompatible with today share company development and business operation, the dearth of literature, dominance of state ownership, the dearth of institutional framework for corporate governance of share companies, absence of organized stock market, absence of corporate governance system and lack of adequate research on the subject. And hence in this research work the basic question therefore be asked what does corporate governance practices landscape indicated in Ethiopia in today's corporate business within this backdrop of low economic, social and infrastructural indicia, weak political fabric and systemic governance challenges including economic and corporate mismanagement, capacity and managerial deficits.

2. Objective of the Study

The objective of this research paper is to assess corporate governance practices in Ethiopia and specifically to spotlight corporate governance practices landscape of Ethiopian share companies in different epochs.

3. Research Methodology

This section makes a brief introduction regarding the research approach followed: sampling techniques and sample sizes, methods of data collection and data analysis are explained in a nutshell.

Target population and samples: The target population is the share companies operating by issuing initial public offerings and the financial sectors are purposively selected i.e., banks and insurance share companies seventeen banks and eleven insurance share companies were considered. The financial sector is selected due to the reason behind that the sector is highly sensitive to financial crisis or failure due to weak corporate governance system and practices which may affect adversely the other sectors too. Sample respondents are executives from share companies, government authorities and other stakeholders were considered.

Methods of Data collection: the data were collected through interview and survey instruments conducted to different stakeholders like government executives playing supervisory role and institutions playing advisory role: National bank of Ethiopia, Ethiopian Ministry of Trade, Ethiopian chamber of commerce and Ethiopian Institute of corporate governance; share companies executives from corporate leader: board secretary, CEOs, Executive Assistants, general managing directors.

Methods of data analysis: qualitative analysis techniques were used to make description based on the information collected to understand the real corporate governance practice scenario in the country together with this content analysis were carried out which is one of the qualitative methods of analyzing data for the purpose of discussion and getting insight on corporate governance landscape by looking into the financial reports and their web pages. Content analysis was performed using grounded research techniques the analysis followed as closely as possible the grounded theory principles of theory generation that were first described by Glasser and Strauss (Whiteley, 2000). Scope of the study considered corporate governance practices which are indispensable for the healthy growth of companies were considered that is the regulatory and policy frameworks, transparency and disclosure practices, board structure and practices, remuneration, minority interest protection and the overall status of corporate governance landscape were considered. Limitation of the study it is confined to corporate sectors operating their business dealings on financial sectors particularly the banking and insurance companies' regarding corporate sector executives contacted therefore; other corporate Sectors executives are not taken into account even though the data regarding the overall corporate governance practice is collected from other stakeholders playing supervisory and advisory roles also.

4. Related Literature Review

4.1. Theoretical overview of corporate governance

The normative empirical research paradigm suggests that "good research" must be grounded in and built on extant theory. So that, in this research work different existing theories of corporate governance are taken into account namely the agency theory, shareholders theory, stewardship theory, stakeholder theory, resource dependency theory and Signalling theory have been used in developing the best practices of corporate governance. Agency theory: the separation of ownership and control creates an inherent conflict of interest between the shareholders and the management (Aguilera et al., 2008). Shareholder theory: corporate organizations' use its resources and invest in business that will maximize its profits (Lee, 2008). Stewardship theory: unification of the position of CEO and board chair to reduce agency costs and promote unity of command doctrine. One of the most viable paths to achieving board effectiveness and performance variation is conditioned on degree of board dependency with greater executive directors' involvement (Davis et al., 1997). Stakeholders' theory: recognizing the fact that firms does not operate in isolation but within an environment made of different interest groups under this theory, the purpose of firm shifts from pursuing shareholder value maximization to that which encompasses other stakeholders' expectations (Kirk bride et al., 2004). Resource-dependence theory: appreciates the strategic importance of other stakeholders beside the immediate shareholders in guaranteeing firms' access to resource through affiliation with various constituencies (Tricker, 2009). Signalling theory: under information asymmetry, corporations with superior information transparency signal better corporate governance. Signalling theory posits that the most profitable companies provide the market with more and better information (Laura Bini, Francesco Giunta and Francesco Dainelli, 2010).

4.1. Empirical Studies

History tells that share market has existed in Ethiopia pre 1974 that is during the Imperial epoch. According to Von Pischke (1968), Ethiopian stock market Pre 1974 was moderately successful in its pioneering efforts to provide an organized market for companies whose shares were relatively widely held companies despite limited participation of the public and investors to invest in stocks and noted that though market capitalization remained small and did not have much impact on the economy, workable share trading environment had been developed. The corporate business operation as well as regulatory framework was in good starting and operations, however, there had existed a rudimentary share market in Ethiopia (Tiruneh Legesse, 2012) all activities enlighten for share company business and governance practices strengths in the country at that time because most of the activities performed at that time were showing good start for the development of good corporate governance practices and corporate business operations supported by today's researchers empirical findings. Researchers raised absence of an organized capital market; state dominance of ownership; inadequate shareholder protection in laws; non-competitive market structure etc are considered as the main challenges or hindrances for the development of good corporate governance practices in Ethiopia post 1974 epochs and most of those hindrances are still exited in the present era too (Asrat Tessema, 2003; Asenakech Ayele, 2013; African Development Bank, 2011; and Tiruneh Legesse, 2012). Though the present epoch that is post 1991 government has introduced an economic system which encourages the private sector, which is expected to play a critical role in Ethiopia's economic development state and political party ownership dominance is still existed which impairs the governance practices furthermore, Lack of adequate legislative provisions on governance issues related to the separation of supervision and management responsibilities, and on the composition, independence and remuneration of board of directors in share companies; the status of corporate governance in Ethiopia is disappointing and noted that the Commercial Code of 1960 does not provide adequate legislative response to complex governance issues of the day; the closed nature of the Ethiopia financial sector in which there are no foreign banks, a non-competitive market structure, and strong capital controls in place; lack of adequate protection of minority rights, non-competitive market structure, absence of accounting standard regarding financial reporting and disclosure, high government intervention; lack of corporate governance awareness, absence of national standards of corporate governance, inadequate shareholder protection laws, ineffective judicial system, absence of organized financial market (Ashenafi, B. F. et.al, 2013; Fekadu Petros, 2010; World Bank, 2007; Nigusie Tadesse, 2000; Tiruneh Legesse, 2012; Hussein Ahmed Tura, 2012; Minga, 2008 and Kiyota, Peitsch, and Stern, 2007).

5. Findings, Conclusions and Recommendations

5.1. Findings on Corporate Governance Practices Landscape in Ethiopia

This section of the research paper is organized to make a reflection on corporate governance practices landscape in a nutshell based on results obtained from the interviewee and survey which is analyzed qualitatively on past, present and futures of corporate governance landscape in the Ethiopia by taking into account different eras.

5.1.1. Corporate Governance Landscape in Ethiopia Past

Based on empirical findings which is solicited by the previous researchers and based on the interview and survey carried out the corporate governance practices of share companies in past in the three epochs (Capitalist-Oriented or Pre 1974, communist or 1974 through to 1991 and capitalist oriented or 1991 onwards) showed the corporate business in the form share company was indicating a rising good starting phase at that time in the imperial period and totally the share company dealings and governance drastically at falling stage in the present era that is 1991 onwards though there is tremendous changes in share company business dealings and the formation of many corporate or share company is indicated the rising nature of the business sector but the governance practice were still overlooked.

Based on the data collected in this research even in the last two decades (in capitalist oriented or 1991 onwards) after a lot of changes are done on business dealings on corporate sector but the subject of corporate governance was not given due attention from the regulatory body as well as the business community. The corporate governance practice was voluntary based with a lot of drawbacks with regard to institutional framework, board structure and practices, regulatory and policy framework like lack of up to date national corporate governance codes and principles at the level of the current status of the changing corporate sector developments in the country and the global corporate governance practices today, not considering corporate governance as one of policy perspectives. As well, lack of transparency and disclosure practices, duality, conflicts of interest, inadequate board remuneration package, lack of strong and well balanced board of directors, weakness on supervisory institutions supervision and enforcement powers, certain loopholes on the commercial code, lack of qualified professionals, awareness gap on the subject, lack of social responsibility practices, stakeholders' rights is not adequately protected and lack of ethics in business dealings are the major shortcomings that is observed from the interview and survey carried out in this research work.

5.1.1. Corporate Governance Landscape in Ethiopia Present

Presently Ethiopia is determined to attract foreign investors as well as encourage domestic investment. Ethiopian economy is at a stage of transformation. Reforms during the last couple of decades brought market economy, privatization of state owned enterprises and corporate business openings are strongly encouraged there is a noticeable increase of investments and joint ventures with foreign investors are seen raising large amounts of capital from the public through offers of shares in new business ventures. This is an indication of a changing landscape on business ownership and business operation that requires good corporate governance practices in the country. Nevertheless, the Ethiopian company law of the 1960s does not have adequate legislative provisions on governance issues related to the separation of supervision and management responsibilities, and on the composition, independence and remuneration of board of directors in share companies, inadequate regulatory framework, absence of financial market are few of the challenges for the development of good corporate governance practices pointed out by previous researchers (Minga Negash, 2013; Asenakech Ayele, 2013; Hussein Ahmed Tura, 2012 and Federal democratic republic of Ethiopia, 2011). Besides, this research work indentified those challenges are still existing today and weak institutional framework on follow-up and supervision of share company's business dealings, unstructured corporate governance framework or distorted governance structures that led to inefficient economic decision-making, lack of qualified professionals on the subject, most of share companies are led by the rich investors who are the majority shareholders not professionally qualified working in the management aspects as board members, minority rights are not adequately protected still though voting of minority shareholders is performed they are the servants of the majority shareholders not the real minority shareholders representatives, transparency and disclosure problem, lack of national principles and up to date codes that can serve as public policy instrument to assist governments and regulators in their efforts to evaluate and improve the legal, regulatory and institutional framework for corporate sectors are few of the landscapes identified today. And today Ethiopian share companies instead of being wealth generating/creating areas to the investors through entrepreneurialism, innovation, development and exploration they become the area of battle field between the management bodies and the shareholders due to ineffective corporate governance structure, the dearth of ethics, divergence with applicable laws and regulations, weak enforcement on the applicable laws and divergence from international best corporate governance practices. Within these landscapes recently different stakeholders are struggling for the development good corporate governance practice in the country and started to making a lot of changes on the regulatory framework as well as institutional frameworks: A committee organized from ministry of trade, ministry of justice and other professionals are revising the commercial code not yet finalized but a good beginning to incorporate corporate governance aspects in its regulatory framework (commercial code); Ethiopian institute of corporate governance is established by Addis Ababa Chamber of commerce and it is doing on developing draft corporate governance code for the corporate sectors and started making awareness on the importance of corporate governance to the business community by organizing workshops; ministry of trade is making institutional framework changes and formed corporate governance directorate that can make follow up on corporate sectors only and ready to make awareness creation starting from federal level up to regional and district level as to the significance of good corporate governance; the National Bank of Ethiopia is issuing various directives with regard to financial sectors corporate governance the recent bank corporate governance directives No.SBB/62/2015 and Insurance corporate governance directives No.SIB/42/2015 though these directives did not indicated regarding related party transactions disclosure to the shareholders rather they request to disclose to governing body only (the national bank) and to some extent the financial sectors corporate governance resembles alive than the other sectors due to the fact that NBE is issuing different directives with regard to corporate governance in financial sectors.

5.1.1. Corporate Governance Landscape in Ethiopia Future

Ethiopia has undergone rapid economic transformation and able to make changes in business environment in the past twenty years. This changing business environment requires the positive reaction of good corporate governance practices which must respond to the needs of the different stages of reform that the country is doing on business operations. Corporate governance is not something that should be handled by corporations, as the name implies; Governance is more than just board processes and procedures it involves the full set of relationships between a company's management, its board, its shareholders and its other stakeholders, such as its employees and the community in which it is located. The country is expected to care about the quality of corporate governance practices in future to sustain a stable economic growth or for the sake of healthy business development. Why should we care about the quality of corporate governance? There are several reasons. An immediate one is that poor governance can harm national economic performance and ultimately global financial stability. According to (OECD, 2000) the financial crises in Asia, Russia and elsewhere have demonstrated this. Though circumstances differed, what crisis countries all had in common was distorted governance structures that led to inefficient economic decision-making. Due to this reason, in future Ethiopia is motivated to bring about the development of corporate governance and caring for the quality of corporate governance practices and reforms or changes on the regulatory and institutional framework regarding corporate governance is a recent phenomenon and different authorities are making themselves ready to make awareness creation on the subject these all changes and beginnings are very essential for the development of corporate governance in the country in future.

5.2. Conclusion

This research paper was carried out by bearing in mind on the recent corporate scandals that have been focused the minds of governments, regulators, companies, investors and the general public on the weaknesses in corporate governance systems and the need to address this issues that has been highlighted by an increasing body of academic research i.e., (regulatory framework, board structure and practices, minority shareholders rights protection, board diversity, disclosure and transparency).The researcher conclude on the landscapes of corporate governance practices in Ethiopia: past, present and future pointed out previously every business dealings are state owned as well as the governing body is government and corporate governance practice was not an issue or not considered as an important subject in country. Today because of changes on business dealings in country a number of companies are formed though those changes are made not backed up by continuous updating on the regulatory framework that take into account those changes and the current corporate governance best practices of the world. And the corporate governance structure is distorted in nature; board structure and practices lacks independence; lack of business ethics, inadequacy of board remuneration; minority shareholders are not adequately protected; lack board diversity; and weaknesses on disclosure and transparency are the most common weaknesses in the corporate governance systems of most share companies in Ethiopia . The chronic weaknesses of most share companies corporate governance system is lack of business ethics and lack of adequate disclosure and transparency as stated by signalling theory corporations with superior information transparency and disclosure signal better corporate governance. To ensure the existence of better corporate governance in share companies in the country share companies are expected to make adequate disclosure and transparency to the shareholders but not in practice. Besides, those corporate governance system weaknesses existed today there is a bright future for the development of good corporate governance practices in the country since there are a lot of beginnings are rising on the subject such as the formation of Ethiopian Institute of corporate governance, institutional framework changes, issuance of directives by the national bank of Ethiopia on corporate governance to the financial sectors. All these indicates the country is awaking and planning to flourish the subject through training and awareness creation of the business community from federal up to regional level; revising the old 1960s commercial code by identifying the loopholes of the code and started by incorporating the current good corporate governance best practices all these support the conduct of healthy business dealings and are the future landscapes of corporate governance in the country.

5.3. Recommendations

- The country should develop generic and sector specific corporate governance codes of best practices, covering all companies generally, state-owned enterprises, cooperatives, financial sectors, reporting and disclosure and on the role, duties and obligations of board of directors, shareholders and members.
- The Ethiopian institute of corporate governance and ministry of trade should be encouraged to work more on the subject through panel discussion on contemporary issue of corporate governance practices with the business community and different stakeholders to create awareness how it is important for the success of their business and growth of the country's economy.
- The country should establish an institute of directors for training, raising awareness and education for business community, CEOs, directors and board members by enriching the institute with qualified human resources on the area of corporate governance.
- The Trading or business policy should also consider the corporate governance policy perspectives because business growth through investment and foreign capital flows can be ensured when it is backed up by good corporate governance policy framework to induce investment in the country.

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