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COLLEGE OF ARTS AND SOCIAL SCIENCES

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MSC (BUSINESS LAW)

Legal framework governing corporatized State-owned Enterprises (SoE) in Rwanda.

Thesis submitted in partial fulfillment of academic requirements for the award of the Master's Degree in Business Law

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Kigali, May, 2015

CERTIFICATION

I, The undersigned certify that I have read and hereby recommend for deposit a Thesis entitled **Legal framework governing corporatized State-owned Enterprises (SoE) in Rwanda**" in fulfillment of the requirements of a Master's Degree in Law from the National University of Rwanda

……………………………………………………………………………………..

Dr. Faustin NTEZIRYAYO

DECLARATION

I,**Alloys MUTABINGWA,** declare that this thesis is original. It has never been presented to any other university or institution. Where other people's works have been used, references have been provided, and in some cases, quotations made. In this regard, I declare this work as originally mine.

Signature……………………………………….

DEDICATION

To the Almighty God who is all in all. His hand holds me and does it all, with immeasurable mercy, love and power. His providence, direction and intervention led me into seeing the light of day.

To my family; my loving, God sent and caring wife Scovia Gahongayire Mutabingwa, my daughter Keza Ivy Mutabingwa, who spared me all the time needed and supported me all through. This work is successfully done due to their constant prayers, support before, during and at completion of my studies. My family is a treasure, source of my strength and a unique gift from God.

To my bed ridden mother and father, from whom I learnt to be resilient and optimistic.

To my colleagues and friends who supported me morally and otherwise.

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Completing such an assignment is always an arduous task which can never become successful without active participation of a number of people. The success in completing this study depends on several factors and individuals. I therefore wish to express my gratitude to them all.
Singling out of few names would leave me with a moral and intellectual debt, thus by mentioning some of them only means citing a few examples.

I would like to sincerely thank my worthy supervisor, Dr Faustin NTEZIRYAYO for helping and guiding me from the initiation to the finalization of this study. He has not only been a guide but also a mentor throughout my research.

Lastly, I thank my work mates, friends and classmates for their continuous support and encouragement during my study. Without your kind support, it would have been impossible to accomplish this work.

Alloys MUTABINGWA

LIST OF ABBREVIATIONS AND ACRONYMS

Art. : Article

BITs : Bilateral Investment Treaties

CACG : Commonwealth Association of Corporate Governance

EAC : East Africa Community

GDP : Gross Domestic Product

GLC : Government-Linked Company'

Ibid : *Ibidem* (Same book, same author same page)

Id : *Idem* (Same book, same author, and at different pages)

MAI : Multilateral Agreement on Investment

N^{o} : Number

NOCs **:** National Oil Companies

OECD : Organisation for Economic Co-operation and Development

Op.cit : *Opere citato* (cited above)

P : Page

SADC : Southern African Development Community

SOEs **:** State - Owned Enterprises

UK : United Kingdom

US : United States

vol : Volume

TABLE OF CONTENTS

CERTIFICATION i
DECLARATION ii
DEDICATION iii
ACKNOWLEDGEMENTS iv
LIST OF ABBREVIATIONS AND ACRONYMS v
TABLE OF CONTENTS vi
CHAPTER I: GENERAL INTRODUCTION 1
I.I Background 1
I. 2. Research problem 5
I. 3. Interest .... **Error! Bookmark not defined.**
I.4.Aims and objectives of the study 6
I.5. Justification of the research 7
I.6. Scope of the study 8
I.7. Methodology 8
I.8. Outline of the research 9
CHAPTER I: CONCEPTUAL AND THEORETICAL FRAMEWORK OF CORPORATIZATION 9
I.1.Conceptual Framework 9
I.1.1. Corporatization 9
I.1.2. State-owned enterprise (SOE) 11
I.1.3. Corporate Governance 12
I.1.4. Public Governance 12
I.2. Theoretical framework on corporatization of state owned enterprises 14
I.2.1.Advantages of state-owned enterprises 14
I.2.2.Disadvantages of state-owned enterprises 15
I.2.3.Basic Guidelines on Corporate Governance of SOEs 16

I.2.3.1. OECD Corporate Governance Principles 16

I.2.3.2. OECD Guidelines on State-Owned Enterprises 17

CHAPTER II. LEGAL AND INSTITUTIONAL FRAMEWORK ON ORGANIZATION OF STATE- OWNED ENTERPRISES IN RWANDA 18

II.1. Legal framework.. 18

II.2: The case of Rwanda.. 22

II.2.1: Competitive neutrality in respect of public procurement 23

II.3 Regulating SOEs in Rwanda 24

II.3.1Rwanda Company law 24

II.3. 2.Law Regulating Capital Markets in Rwanda 26

II.3. 3.Bilateral and multilateral investment treaties 27

II.3.4. Status of corporatization and corporate governance in Rwanda................................ 28

II.3.4.1Legal rules governing public institutions 29

II.3.5. Upon corporatization, which is the law providing for governance of the SoE? 30

II.4.0 Legal issues of post-corporatization of SOE's, privatization, public- private partnerships... 32

II.4.1.Lack of a general law codifying the principles of governance of corporatized SoE's in Rwanda 34

II.4.1.1.Governance challenges in State Owned Enterprises 35

CHAPTER III. LEGAL MECHANISMS FOR ENHANCEMENT OF CORPORATIZATION IN RWANDA 36

III.1.Legal Mechanisms For An Effective Corporatization 36

III.1.1.Strengthening the legal and regulatory framework 36

III.1.2.Ensuring an Effective Legal and Regulatory Framework for State Owned Enterprises 37

III.1.3. Implementing OECD and CACG Principles of Corporate Governance in Rwanda . 38

III 1.4. Corporate governance as key pre-requisite for successful corporatization 38

III.2. INSTITUTIONAL MECHANISMS 40

III.2.1. Avoiding governance failure of State Owned Enterprises in Rwanda 40

III.2.2. Re-inventing State Owned Enterprises in Rwanda.. 41

III.2.3.Legal rules for an Effective Corporatization Framework.. 42

CHAPTER IV: GENERAL CONCLUSION AND RECOMMENDATIONS...................... 43

IV.1: RECOMMENDATIONS 44

BIBLIOGRAPHY 47

I. LEGISLATIONS 47

II.CASE LAW 47

III.BOOKS 48

IV.REPORTS AND OTHER DOCUMENTS 50

V. INTERNET SOURCES 50

GENERAL INTRODUCTION

I.I Background

The drive to corporatize the existing State Owned Enterprises (SoE) in Rwanda is geared towards achieving a higher level of productivity, efficiency, accountability and transparency in the delivery of essential services and goods to the public.

The term corporatization may be borrowed from *investopedia* providing the following definition:[1] "*The act of reorganizing the structure of government owned entity into a legal entity with the corporate structure found in publicly traded companies. These companies tend to have a board of directors (B of D), management and shareholders. However, unlike publicly traded companies, the government is typically the company's only shareholder and that the shares in the company are not traded publicly.*

The main goal of corporatization is allowing the government to retain ownership of the company but still enable it to run as efficiently as its private counterparts because government departments sometimes are inefficient with the level of bureaucracy involved. Furthermore, the government may one day feel that the private sector could do a better job of running the company, possibly conducting an offering on the stock market in order to divest it."

As J. Scott points out, the key features of corporatization include creating a legal entity separate from Government structures, with managerial autonomy, transparency and with separate reporting system.[2] The legal entity takes over the asset, where need be the liabilities as well as staff of the predecessor. The entity is governed by the Board of Directors who represents investors' interests.[3]

Whilst management processes have been widely explored, relatively little attention has been paid to the processes by which companies are governed. If management is about running businesses,

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[1] http://www.investopedia.com/terms/c/coporatization.asp, accessed on 9th January,2015
[2] Scott J, *Corporate Business and Classes,* Oxford: Oxford University Press, 1997, p.29.
[3] Romano R ,*Foundations of Corporate Law* , Oxford: Oxford University Press, 1993, p.25.

governance is about seeing that it is run properly. All companies need governing as well as managing.[4]

On whether corporatization should be seen as a progressive form of public service delivery or, by contrast, as a precursor to deeper forms of commercialization. Writings in favor of corporatization tend to celebrate market-based management as an effective way to depoliticize public services and improve efficiency through marketization.[5] Research also reveals positive examples of corporatized service providers in the South where equity, accountability, sustainability and other progressive indicators of 'publicness' are taken seriously, suggesting that not every corporatization is created equal.[6]

Those opposed tend to see corporatization as the proverbial wolf in sheep's clothing, offering a façade of public ownership while propagating market ideology and advancing corporate accumulation; a form of privatization without the political and financial risks associated with direct private sector participation.[7]

Much of the debate has focused on countries in the North, but the literature on corporatization in the South is equally bifurcated. The World Bank is arguably the most prolific and influential pro-corporatization advocate in this regard, offering up textbook rationales for why it should be done, along with pecuniary incentives for corporatized reforms throughout Africa, Asia and Latin America.[8]

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[4] Bai, C. E., Li, D., & Wang, Y. J. Thriving on a tilted playing field: China's non state enterprises in the reform era, *How far across the river?: Chinese policy reform at the millennium* , Stanford University Press, 2003, pp.97-121.

[5] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books, Chapter 1; P.4 http://www.municipalservicesproject.org/userfiles
Blum, D. and C. Ullman ,'The globalization and corporatization of education: the limits and liminality of the market mantra', *International Journal of Qualitative Studies in Education*, 2012,p.25, http://utep.influuent.utsystem.edu/en/publications/the-globalization-and-corporatization-of-education%2888aae562-9292-4e8a-be3a-cf962962d8c5%29.html, retrieved o 9th January,2015.

[6] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books, Chapter 1 *P.5 http://www.municipalservicesproject.org/userfiles, accessed 02/05/2015*
& Blum, D. &C.Ullman,ibid.P.25

[7] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.4
Farazmand, A. ,*Public Enterprise Management: International case studies*, London: Greenwood Press, 1996, p14.

[8] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.4-5
Fink, L. ,'Corporatization and what we can do about it', *History Teacher*, 2008,p. 33.

Opponents point to the especially pernicious effects of corporatization in low-income countries, where publicly owned service providers can prove to be even more commercially oriented than their private sector counterparts. The opponents point out that experiences persuade many that corporatization is little more than a ruse for commercializing service delivery in the South while deceiving people into thinking that the crisis of privatization has been averted[9]. This would lead into cutting off services to poor households, building multi-tiered service systems, aggressively pursuing private sector contracts outside their home country, and valorizing new moral codes of conduct around the 'responsibility to pay' for market-oriented services.[10]

Preliminary investigations found corporatized utilities that appeared to have bucked the neoliberal trend to varying degrees, openly resisting marketized forms of public management. The selected cases are not the only such examples in the world today, but they offer detailed, comparative insights into how and why some corporatized utilities in countries of the South have managed to retain an equity-oriented, and less commercialized, public ethos[11]

A case has been made for the need to move beyond the dualistic opposition that plagues much of the debate on contemporary public sector reform, labelling models as *either* 'empowering the public' *or* 'just another means of strengthening neoliberal rule'[12].

A reflection on what is actually happening on the ground is important, 'suggesting a number of ways in which publicness is being disassembled and reassembled.'[13]The ability of local politicians, workers, community organizations and other anti-co modification groups to resist neoliberal reforms exists – and is remarkably strong in some places, making corporatization to be

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[9] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.5 http://www.municipalservicesproject.org/userfiles

10 Aharoni, *Y.,State-owned enterprise: An agent without a principal,* New York: Cambridge University Press, 1982, pp.67–76.

[11] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.5 http://www.municipalservicesproject.org/userfiles, accessed 02/05/2015

Preker, A. S. and A. Harding, Innovations *in Health Service Delivery: The corporatization of public hospitals*, Washington, DC: World Bank, 2003,p.11.

[12] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.6 http://www.municipalservicesproject.org/userfiles, accessed on 2nd May,2015

[13] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.6 http://www.municipalservicesproject.org/userfiles,accessed on 2nd May,2015

Newman, J. and J. Clarke ,*Publics, Politics and Power: Remaking the public in public services*, Thousand Oaks, CA: Sage Publications,2009,p.14.

a fragile alternative as it is haunted by forces of marketization from within and without.[14] Pro-corporatization literature tends to rely on a narrow set of financially oriented performance criteria that pay little attention to questions of equity and affordability[15].

Anti-corporatization research tends to be critical of these restrictive financial criteria but does not always specify what the alternatives might look like or how they might be evaluated.[16]

The study should enable the Government, and other stakeholders to scope out areas of law requiring improvement with the view to support and protect corporatization and ultimately enable FDI investment growth in the public utilities sector in Rwanda. The study benchmarks corporate regime in Rwanda with internationally accepted standards while reflecting on practices in other jurisdictions.[17]

The implementation of research findings would re-engineer Government's efforts towards corporatization and divestiture of its public utilities enterprises. Particularly, the study inspires and guides the process of enacting a code of corporate governance for corporatized SoE's
The study makes a humble contribution to the study of the law on corporate governance, corporatization and divestiture of SoEs in Rwanda. In particular, the study reflects on a set of legal rules to underpin governance of State Owned Corporations in Rwanda.

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[14] Ocko, J. and L. Campo ,'Focus on the corporatization process in China', *Duke Journal of Comparative and International Law*, 1994,p.7, w.municipalservicesproject.org/userfiles/McDonald_Chap1_Public_Ambiguity_and_the_Multiple_Meanings_of_Corporatization.pdf, retrieved on 2n May,,2015

[15] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.5 http://www.municipalservicesproject.org/userfiles, retrieved on 2nd May,2015
OECD (Organisation for Economic Cooperation and Development, *OECD Guidelines on Corporate Governance of State-owned Enterprises*, Paris: OECD Publishing, 2005, p.14.

[16] McDonald, D.A.2014, Re-thinking corporatization and public service in the global South.London; Zed Books,Chapter 1; P.6 http://www.municipalservicesproject.org/userfiles retrieved on 2nd May,2015
Oum, T. H., N. Adler and C. Yu ,'Privatization, corporatization, ownership forms and their effects on the performance of the world's major airports', *Journal of Air Transport Management*, 2006,p.21, http://www.sauder.ubc.ca/Faculty/Research_Centres/Phelps_Centre_for_the_Study_of_Government_and_Business/Projects/UBC_P3_Projects/~/media/Files/Faculty%20Research/Phelps%20Centre/2006_02_oum.ashx, accessed on 15/02/2015

[17] Such as Kenya, South Africa ,Tanzania, Ghana, etc.

I. 2. Research problem

This study sheds some light on the governing law and identifying gaps and barriers in the existing laws. Corporatization presumes change mostly from public law to private law, but keeping public interests intact. The study on Rwandan law seeks to establish the importance to carefully develop a system by which such State-owned-Enterprises are directed and controlled.[18]

Ownership and control of government owned companies presents a major legal challenge in corporate law, creating new legal scenarios regarding the accountability of directors, the independence of government owned companies, competitive neutrality where there is quest for a level-playing field between SoEs and private counterparts.

The research considers some of the key corporate governance issues emerging from corporatization of state owned enterprises. The attempt to apply same legal rules obtaining in corporate law to the corporatized state owned and controlled companies have inherent issues that are discussed in the study.

I. 3. Interest

The study examines attempts to corporatize SoEs through changes in their corporate culture and rules as embedded in the guidelines and standards, such as the OECD Guidelines on the Corporate Governance of State-owned Enterprises. In this study we do not suggest that the United States, Germany, or Japan model be emulated, rather we advocate for significant legal protection measures for prospective private investors for PPP financing management of corporatized SoEs.

[18] Bebchuk, L. A., & Fried, J. M, *Pay without performance,* Harvard University Press Cambridge, MA, 2004, p27.

The argument in this study is that for a country to attract FDI and institutional investors[19] in a public utility sector, it is assumed that a host country has put in place an appropriate legal and institutional framework to govern the enterprises in the sector on an equal legal footing between public and private actors. Some scholars[20] attribute the poor performance of SoE's to political interference, management red-tapes and inefficient governance structure. With such factors enterprises cannot increase investment portfolios, improve sales, improve collection of bills, and cut costs.

In conducting this study two research questions were considered, namely:

- How and why should the Rwandan law provide for corporatization and corporate governance of state-owned enterprises
- What is the appropriate legal framework for an effective and efficient corporatization of Rwandan state-owned enterprises?

I.4.Aims and objectives of the study

This study identifies the legal and institutional aspects underlying governance of a State Owned Corporations. The study explores a number of legal issues affecting governance including the following:

a) Identifying the leverage between state's exercise of enterprise ownership to nominate and elect the board, but ensuring that it refrains from any undue political interference in the management of the enterprise.
b) Allowing a level-playing field in markets where private sector companies can compete with state-owned enterprises and government do not distort competition in the way they use their regulatory or supervisory powers.

[19] "Institutional Investors" is a term used to refer to organizations that invest individual's funds, say savings and pensions, into the financial market by buying securities like shares and bonds, and assets like commercial buildings with the aim of making a profit on these investments. The best examples of Institutional Investors are Banks, Insurance companies, Pension Funds and Mutual Funds.

[20] Carlier, A. *Social dimensions of corporate restructuring (social safety net component) , Implementation completion report*. World Bank. Washington, DC, 2001, p.14.

c) Ensuring that the governance of such Corporations adheres to the main guiding principles in the delivery of public utilities, namely: accessibility, adaptability, conflict resolution, continuity, equality, participation, transparency, and universality.

The main aim of this study, therefore, is to bring to light the necessity of enacting a tailor-made corporate governance code for the corporatized SoEs for the following core purposes:

- To provide adequate legal safeguards for private capital in general and FDI flow into State-Owned Enterprises in Rwanda.
- To ascertain the need for a guide on corporate governance for corporatized SoE's in Rwanda.
- To subject the on-going reform trends to the generally acceptable principles and rules on governance of corporatized state-owned enterprises (SoE).[21]

I.5. Justification of the research

Presently there is a highly limited literature and empirical studies on the subject of corporatization and corporate governance law and its underlying concepts in Rwanda. The available literature on corporate governance and corporatization law in Africa mainly focus on South Africa (King Report I, II & III)[22] the emerging economies in the rest of the continent are not covered. The rules and mechanisms for safeguarding sound corporate governance in Africa constitute an essential pillar in the corporatization and divestiture of SoE's in Africa[23].

In the light of a growing investor appetite for Rwanda's state owned enterprises, this study contributes to the process of formulating and consolidating legal fabric for corporate governance.

[21] Water and energy accessibility, adaptability, conflict resolution, continuity, equality, participation, transparency, and universality.

[22] Wikipedia.org/wiki/King_Report on corporate governance. King report I issued in 1994, King report II issued in 2002 and King Report III issued in 2009-retrieved on 20th January,2015

[23] Banhegyi,Steve(2007), Management Fresh perspectives. Pearson Education South Africa, at p.317 cites King report as " the most effective summary of the best international practice in corporate governance, available on website:wikipedia.org/wikiking_report on corporate governance, retrieved on 1st May,2015

This study may serve as a useful reference in all future decisions on legal and governance options available to the Governments in their quest for legal and institutional reform initiatives for SoE's.

I.6. Scope of the study

This study explores the different ways through which governance and performance of a State-Owned (SOE) can be improved. These include Government supply, operations and maintenance, corporatization as well as divestiture. The study review the current reform trends for SoE legal and governance restructuring and corporatization in Rwanda. Throughout the study we maintain focus on state owned enterprises only.

I.7. Methodology

The research is of the qualitative type which involves study of books, electronic/internet sources, journal articles, theses and dissertations, decided cases and legislation. The existing literature is subject to scrutiny in this study. The analysis is done from the perspective of corporate governance law taking into account the way in which corporate laws and regulations play an important role in corporate governance. The study benchmarks Rwandan legal regime on governance of SoE's against some of the relatively developed systems. The following methods are used in this study:

- Gathering and review of laws and regulations relevant to the subject,
- Collection and review of academic and advisory materials that present the options for improving governance of public enterprises in other jurisdictions,
- Review of Court decisions relevant to the subject

I.8. Outline of the research

This thesis starts with the general introduction followed by three chapters. Chapter one looks at the theoretical and conceptual framework of corporatization, chapter two deals with the legal and regulatory framework on corporatized states owned enterprises currently in place in Rwanda and chapter three deals with the mechanisms on the enhancement of the corporatization of SoE's in Rwanda. The study ends with a general conclusion and recommendations.

CHAPTER I: CONCEPTUAL AND THEORETICAL FRAMEWORK OF CORPORATIZATION

From various definitions of corporatization, corporatization structure is the core of a modern enterprise system. Different authors provide broad and narrow definitions of the term corporate governance.

I.1.Conceptual Framework

Corporate governance has had no precise and commonly accepted definition, mainly due to the contextual point of departure of the one defining the term. The concept of "corporate governance" derives from an analogy between government of nations or states and governance of corporations.[24]

I.1.1. Corporatization

Corporatization is the process of transforming state assets, government agencies, or municipal organizations into corporations. It refers to a restructuring of government and

[24] M.,BECHT ,Corporate Law and Governance , see https://www0.gsb.columbia.edu/faculty/pbolton/BBRLE.pdf, accessed on 17th March2015.

public organizations into joint-stock, publicly listed companies in order to introduce corporate and business management techniques to their administration.[25]

The result of corporatization is the creation of state-owned corporations where the government retains a majority ownership of the corporation's stock. However, in many cases, corporatization is a precursor to partial or full privatization, which involves a process where formerly public functions and public enterprises are sold to private business entities by listing their shares on publicly traded stock exchanges.[26]

Corporatization of state enterprises and collectively owned enterprises was a major component of the economic restructuring program of the People's Republic of China.

China's contemporary "socialist market economy" is based on a corporatized state sector where state companies are owned by the central government but managed in a semi-autonomous fashion.[27]

In contrast, the term may also refer to the construction of state corporatism, where state-owned corporations are created and delegated public social tasks resembling corporate nationalism as an alternative to privatization. Corporatization can also refer to non-corporate entities like universities or hospitals becoming corporations, or taking up management structures or other features and behaviors employed by corporations[28]

Corporatization attempts to explicitly separate political considerations (support of favored groups who vote or provide campaign funds for candidates) from economic considerations (involving the financial sustainability of the SOE and performance improvements). Clearly, that separation will not be total, but long term objectives social and economic objectives are more likely to be met by instituting procedures that improve governance within the operating company and that

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[25] Investopedia. "Corporatization", retrieved at www.investopedia.com. Accessed on 17th April 2015.
[26] see http://fufaw.blogspot.com/2014/04/corporatization.html), accessed 17th April,2015
[27] World Bank, "Reform of China's State-owned Enterprises, A Progress Report of Oxford Analytica", February 2015, p17.
[28] http://fufaw.blogspot.com/2014/04/corporatization.html, accessed March,11th,2015

strengthen accountability. Furthermore, corporatization serves as the basis for commercialization. [29]

I.1.2. State-owned enterprise (SOE)

A state owned enterprise is an organization that is owned and controlled by the government. A state owned enterprise is the exact opposite of a private enterprise which is owned by private individuals. This definition of "state-owned enterprises" includes only wholly state- funded firms. This narrow definition by and large implies a prior-reform ownership status of SOEs, in which corporatization and privatization reforms have not yet been fully implemented. This kind of classification of "state-owned enterprises" has statistical challenges.[30]

This definition of SOE do not cover the ownership forms of share-holding cooperative enterprises, Public-Private Partnership(PPP) enterprises, limited liability corporations, or shareholding corporations, whose majority shares are owned by the government, public organizations, or the SOEs themselves. Despite its obscurities and underestimation problems, this narrow definition of SOEs has been used for statistics on labor and state-owned assets between central SOE's and other SOEs.[31]

The term "state-owned and state-holding enterprises" has been used since the mid-1990s. State-owned and state-holding enterprises refer to state-owned enterprises plus state-holding enterprises, where state owned enterprises are, as aforementioned),wholly state-funded firms and the definition of "state-holding enterprises" is such that they are those firms whose majority shares belong to the government.[32]

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[29] http://regulationbodyofknowledge.org/faq/state-owned-enterprises/what-is-corporatization/) retrieved March,12 2015

[30] OECD, State Owned Enterprises in China: reviewing the evidence, onhttp://www.oecd.org/corporate/ca/corporate governance of state owned enterprises/42095493.pdf,accessed on 15th April 2015.

[31] *Ibid.*

[32] 8 In this context, the listed companies whose majority shares belong to the government should be classified as "state-holding enterprises," not "state-owned enterprises." Their mother companies, however, which are usually wholly state-funded firms, could be classified as "state-owned enterprises."

I.1.3. Corporate Governance

Corporate Governance as defined by United Kingdom's Code refers to a system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.[33]

With regard to the nexus between governance and management structure, management can be depicted as a hierarchy. The board of directors or other governing body is superimposed on management. A unitary board has both outside, non-executive directors and executive directors, who must wear two hats – as directors on the board and top executives in the management hierarchy. The different power structures of boards composed entirely of executive directors, those with a minority of outside, non-executive directors, those with a majority of outside, non-executive directors, and supervisory boards composed entirely of outside directors.[34]

I.1.4. Public Governance

Public governance has been defined as the relationships that exist between Parliament and the Executive, on the one hand, and Ministers and management of public sector agencies, on the other hand, focusing on accountability and responsibility for the management of public resources and delivery of programs and services.[35]

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[33] The first version of the UK Corporate Governance Code (the Code) was produced in1992 by the Cadbury Committee. Its paragraph 2.5 is still the classic definition of the context of the Code.

[34] Tricker, R.I.,, Corporate Governance - principles, policies and practices, Oxford University Press, Oxford, 2009, p.12.

[35] Public Governance: It's Meaning and Importance for the Public Sector and Audit See http://www.audit.sa.gov.au/98-99/a3/meaning.htm, accessed on 8 January 2015.

It is also noted by the proponents of the above definition that effective and sound public governance arrangements are crucial for the management of national resources.[36] Public governance has a direct impact on the management of SOEs. The governance discourse of SOEs goes beyond corporate governance and is directly or indirectly influenced by public governance. This is based on the fact that Parliament makes the laws and the Executive makes policy, which laws and policies in turn affect the management of SOEs. It has been argued that SoEs require good governance at both the public sector level and the corporate level.[37]

The principle agent problem arises when one party (agent) agrees to work in favor of another party (principle) in return for some incentives. Such an agreement may incur huge costs for the agent, thereby leading to the problems of moral hazard and conflict of interest. Owing to the costs incurred, the agent might begin to pursue his own agenda and ignore the best interest of the principle, thereby causing the principal agent problem to occur.[38]

The costs to agent and subsequent conflict of interest arise due to the skewed information symmetry and the risk of failure faced by the principal. For example, shareholders of a company appoint managers to look after the proceedings of the company and earn profits on their behalf. The shareholders expect the managers to distribute all the profits to the shareholders. But the managers sensing their own growth and salary expectation try to retain the profits for future as a safe side. This can lead to principle agent problem. It is one of the most noticed problems in the current situation when most companies are not being managed by the owners themselves.[39]

Examples of some techniques commonly used to overcome or alleviate the agency problem would include: (1) profit-sharing bonuses, contingency fees, sales commissions, merit raises, executive stock options and various other contractually specified methods of setting the amount of the agent's financial compensation in proportion to measurable results; (2) organizational hiring and promotion policies for people in responsible positions (agents) that emphasize

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[36] *Ibid.*

37 Aharoni, Y.*The evolution and management of state owned enterprises*,Cambridge, MA: Ballinger Publishing, 1986,p.26.

[38]The Economic Times, Definition of 'Principle Agent Problem' ,accessed on website: http://economictimes.indiatimes.com/definition/principle-agent-problem, accessed on 14/03/2015

[39] Ibid.

identifying and selecting candidates whose reputation (based ideally on past performance) indicate they are "well-motivated," "dedicated to the ethics of the profession," and generally "of good character" — i.e., people who feel a strong sense of moral obligation to do their best to do what they have promised to do, even when no one is likely to be watching; (3) institutional arrangements of accountability (such as boards of directors, auditing committees, inspector generals' offices, professional society ethics committees, and government regulatory boards) for detecting and then punishing extreme dereliction of duty, either by simply firing and disgracing (or perhaps de-licensing) the unworthy agent or possibly by aggressively pursuing civil or criminal penalties through the courts; (4) arrangements such as elections whereby the recent performance of the agent may be periodically scrutinized by his or her principals and competing candidates for the job may be allowed to make their case for replacing the incumbent agent by revealing his or her shortcomings and showing how performance might be improved through a change in command[40]

After analyzing and defining all necessary concepts regarding the subject matter, the following section is devoted to theoretical framework on corporatization of State Owned Enterprises.

I.2. Theoretical framework on corporatization of state owned enterprises

Corporatization continues to be an area of focus for most companies, regardless of whether they are involved in global operations or not. In this section, we understudy the advantages & disadvantages of state-owned enterprises

I.2.1.Advantages of state-owned enterprises

Baldev Bishnoi[41] argues that the following are some of the advantages of a government company:

[40] P.Johnson, A Glossary of Political Economy Terms,from https://www.auburn.edu/~johnspm/gloss/agency_problem, accessed on 14/03/2015

[41] Baldev Bishnoi, What are the Advantages & Disadvantages of Government Company?Accessed on http://www.publishyourarticles.net/knowledge-hub/business-studies/what-are-the-advantages-a-disadvantages-of-government-company.html, accessed on 19th/02/2015

- The formation of government companies is very easy because it is formed like other joint stock companies.
- It is easy to incorporate, to determine its governance rules and make changes thereon from time to time as it owned and controlled by the government.
- Most of the government companies run on sound business lines as they have their surpluses to run their projects.
- A Government company enjoys financial autonomy because they are to depend on the government for initial investment with possibilities of obtaining post-corporatization favours such as subsidies, tax exemption, preference in government tendering, etc. The profit of the companies is utilized for the further expansion activities or for financing government political activities falling out or short of government's regular budget.
- Government companies may facilitate all round industrial development by taking up projects in the neglected areas where private sectors hesitate to invest.
- SOE may provide a healthy competition to private sectors.

I.2.2.Disadvantages of state-owned enterprises

Baldev Bishnoi[42] considers some of the disadvantages underlying state-owned enterprises to include the following:

- Government companies are autonomy in theory, but in practice it is not autonomy because political authorities maintain the ability to interfere in the day-to-day operation of the companies. Since these are dependent on the government for taking important policy decisions, red-tapism in government departments affect the working of companies.
- As most of the government companies take the assistance of civil servants, their level of organizational effectiveness is not engineered by their market efficiency and competitiveness. Most of the government companies experience slackness in management under the grab of public services. This affects efficient as private units because of this state of affairs found.

[42] Ibid.

I.2.3.Basic Guidelines on Corporate Governance of SOEs

The OECD Guidelines on Corporate Governance of State-Owned Enterprises give concrete advice to countries on how to manage more effectively their responsibilities as company owners, thus helping to make state-owned enterprises more competitive, efficient and transparent.

I.2.3.1. OECD Corporate Governance Principles

The aim of the OECD Principles is to assist the governments of OECD countries as well as the governments of the countries which are not yet members of the OECD in their efforts to evaluate and improve their legal, institutional and regulatory framework on corporate governance in their countries and to provide guidelines and proposals for stock exchanges, investors, enterprises and other parties involved in the development of good corporate governance. [43]

The principles are focused on publicly traded companies. In individual cases, the Principles may also be a useful tool to improve corporate governance in enterprises not traded on the stock exchange, both for private and state-owned companies. The Principles provide a common basis which, according to the opinion of the OECD countries, is essential for the development of good corporate governance practices.[44]

The Principles are not binding and their intention is not to give detailed instructions for national legislation. Principally, they try to define goals and propose various ways of achieving them. The Principles should serve as the source of recommended actions. They may be used by policy-makers in developing and verifying a legal and regulatory framework for corporate governance in which the economic, social and cultural characteristics of an individual country are reflected, and also by various market players in developing their own practices.[45]

43 Freeman, R. E. , *Strategic management: A stakeholder approach*, Cambridge: Cambridge University Press, 2010,p.27.

[44] The government of the Republic of Slovenia ,policy on corporate governance of state-owned enterprises ,retrieved onhttp://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/Finan%C4%8Dno_premo%C5%BEenje_in_poro%C5%A1tva/Kapitalske_nalo%C5%BEbe_RS/Politika_upravljanja_podjetij_v_dr%C5%BEavni_lasti/policy_on_corporate_governance_of_stateowned_ent.pdf, accessed on 1/042015

[45] Ibid.

I.2.3.2. OECD Guidelines on State-Owned Enterprises

The OECD Guidelines on Corporate Governance of State-Owned Enterprises define and demonstrate ways of balancing between the State's responsibility to actively implement its ownership functions (such as selection and nomination onto supervisory boards) while at the same time resisting inappropriate political interference in the governance of these enterprises.

The Guidelines explain that in markets where private companies compete with state-owned companies there are equal opportunities; and also, that by the method in which the States apply their legislative and supervisory powers, they do not distort the competition. The Guidelines suggest that the State should exercise its ownership function through a centralised ownership unit which needs to operate independently and in compliance with its publicly disclosed ownership policy.[46]

An important element is a strict separation of ownership and legislative functions of the State. In this way the State's ownership is exercised in a professional and responsible manner, and the State holds a positive role in improving corporate governance in all sectors of the economy.

The Guidelines also propose that the policy-making in regard to the State's ownership steering should be publicly disclosed and that the State should prepare annual reports on policy implementation as well as aggregated reports on the SOEs' performance in order to ensure better transparency of corporate governance of SOEs.

An important element of good corporate governance, as emphasized in the guidelines, is the responsible conduct of SOEs' supervisory and management bodies; the same applies to the relation between the State as the shareholder and these bodies. The Guidelines are specifically dedicated to issues characteristic of the corporate governance of SOEs, and discuss these questions from the point of view of the State as an owner while also focusing on policies that would provide good corporate governance of SOEs. At the same time, the OECD Guidelines do not oppose various policies or privatization programmes carried out by the OECD countries.[47]

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[46] Ibid. See also OECD, OECD Guidelines on Corporate Governance of State-Owned Enterprises, accessed on http://www.oecd.org/corporate/ca/corporate governance of state owned enterprises/oecd guidelines on corporate governance of state-owned enterprises.htm, accessed on 15/04/2015

[47] *Ibid.*

The OECD guidelines have enabled the OECD countries to formulate uniform rules on corporate governance. Using the same OECD guidelines, in chapter II, we examine the Rwandan legal and institutional framework under which SOE's are organized.

CHAPTER II. LEGAL AND INSTITUTIONAL FRAMEWORK ON ORGANIZATION OF STATE- OWNED ENTERPRISES IN RWANDA

This chapter provides insights into the law governing corporatized State-owned Enterprises (SoE), particularly the company law. But it also sheds a light on capital markets law as such corporation may elect to list on capital market. In this chapter, we discuss emerging corporate governance and market competition issues attendant to corporatization. We also understudy the relevant Rwandan laws to reflect on gaps and need for a code of corporate governance for State-Owned-Enterprises (SoE). In our view, the Government of Rwanda needs a uniform code for corporate governance of SOE as a pre-cursor to successful corporatization of SOE. The code should also encompass principles of market competitive neutrality between SOE's and private enterprises.

II.1. Legal framework

Currently, there is no general code for corporate governance in Rwanda, likewise there is no legal framework underpinning the on-going corporatization. However, there is strong advocacy for one to be developed and adopted.

The legal framework currently used for corporatized SoEs is the Company Act[48] of 2009, the Law Regulating Capital Markets[49] of 2011, and the Law Regulating Collective Investment Schemes[50] of 2011. There are other legal and regulatory rules tailor-made either to deal with sector-specific governance issues[51] or to generally regulate the sector,[52] to promote investments[53], to regulate market competition and protect consumers.[54]

[48] Law No.07/2009 of 27th/04/2009 relating to companies
[49] Law No.01/2011 of 10/02/2011 regulating capital market
[50] Law No.40/2011 of 20/09/2011 regulating collective investment schemes
[51] Such regulation as banking Regulation 062008 on corporate governance of banks

It is necessary for countries to codify rules underpinning corporate governance of SoE's and provide for competitive neutrality between SOE and private enterprises. Such rules are needed given that other mechanisms are not sufficient to ensure market equilibrium, fairness, accountability, efficiency and market competitiveness. A specific set of codified rules tailor-made to enable effective corporatization of SoE's guarantees minimum corporate governance standards, market efficiency, investor confidence and general public confidence.[55] In our view, the key success factor in SOE corporatization and governance is their degree of compliance with principles underpinning competitive neutrality.

Competitive neutrality requires equal treatment and equality of arms in the market between SOE's and private enterprises. The rules require that governments not to use their legislative or fiscal powers to advantage their own businesses over the private sector. If governments do advantage their businesses in this way, it will distort the competitive process and reduce efficiency, the more so if the government businesses are technically less efficient than their private sector competitors.[56]Most policy makers would agree that state-owned enterprises that operate in a purely commercial fashion should compete on an equal basis with other companies. The reality, however, is that many SOEs perform both commercial and non-commercial functions. But on the one hand, SOEs may be expected to abide by market principles whilst continuing to fulfill public service obligations, which put them at a disadvantage. On the other hand, there are concerns that SOEs receiving subsidies or guarantees may compete at an advantage, unsettling the competitive landscape and eventually become a fiscal drag for the state.

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[52] The example being the law establishing Public Utilities Regulatory Authority(RURA) which is silent on corporate governance and disclosure requirements(Law No.13/2013 modifying Law No.39/2001 of 31st/09/2001 establishing Rwanda Utilities Regulatory Authority)

[53] Such as the Rwanda Investment Promotion Code , silent on corporate governance and disclosure standards(Law No.26/2005 of 17/12/2005 on investment and export promotion) This code was repealed by Law **N°** 06/2015 of 28/03/2015 relating to investment promotion and facilitation

[54] Law No.36/2012 of 21/09/2012 relating to competition and consumer protection(which does not incorporate pre-requisite rules of corporate governance and disclosure requirements

[55] Schleifer, A & Vishny, R ,*A Survey of Corporate Governance*, Journal of Finance, 1997, p.12.

[56] Capobianco, A. and H. Christiansen (2011), "Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options", OECD Corporate Governance Working Papers, No.1,OECD Publishing. http://dx.doi.org/10.1787/5kg9xfgjdhg6-en-p.5, accessed on 15/05/2015

Therefore the OECD observes that governments wishing to obtain and enforce competitive neutrality need to focus attention on the following seven priority areas:[57]

i) The degree of corporatization of government business activities such that there is structural separation between commercial and non-commercial activities. Separation of commercial from non-commercial activities in public entities enables commercial entities to operate in competitive, open markets, as separate legal entities enhances transparency.

ii) Ensure transparency and disclosure around cost allocation. Separation of costs associated with commercial activity vis-à-vis essential public service obligations remains an important basis for an effective enforcement of competitive neutrality rules. For incorporated SOEs, the major issue is accounting for costs associated with fulfilling public service obligations (if applicable). For unincorporated entities, problems arise where they provide services in the public interest as well as commercial activities from a joint institutional platform.

iii) Devise methods to calculate a market-consistent rate of return on business activities. Achieving a commercial rate of return is an important aspect in ensuring that government business activities are operating like comparable businesses. If SOEs operating in a commercial and competitive environment do not have to earn returns at market consistent rates then an inefficient producer may appear cheaper to customers than an efficient one.

iv) Ensure transparent and adequate compensation for public policy obligations. Competitive neutrality concerns often arise when public policy priorities are imposed on public entities which also operate in the market place. It is important to ensure that concerned entities be adequately compensated for any non-commercial requirements on the basis of the additional cost that these requirements impose.

[57] Capobianco, A. and H. Christiansen (2011), "Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options", OECD Corporate Governance Working Papers,No.1,OECDPublishing.http://dx.doi.org/10.1787/5kg9xfgjdhg6-en, accessed on 15/05/2015

v) Ensure that government businesses operate in the same or similar tax and regulatory environments. To ensure competitive neutrality government businesses should operate, to the largest extent feasible, in the same or similar tax and regulatory environment as private enterprises. Where government businesses are incorporated according to ordinary company law, tax and regulatory treatment is usually similar or equal to private businesses.

vi) Debt neutrality remains an important area to tackle if the playing field is to be levelled. The need to avoid concessionary financing of SOEs is commonly accepted since most policy makers recognize the importance of subjecting state-owned businesses to financial market disciplines. However, many government businesses continue to benefit from preferential access to finance in the market due to their explicit or perceived government-backing.

vii) Promote competitive and non-discriminatory public procurement. The basic criteria for public procurement practices to support competitive neutrality are: (1) they should be competitive and non-discriminatory; and (2) all public entities allowed to participate in the bidding contest should operate subject to the above standards of competitive neutral. This point is discussed separately in light of the Rwandan law relating to public procurement.

Why do Governments tend to depart from competitive neutrality? Some scholars believe that this is mostly possible when the state intervenes in the economy with the purpose of remedying market failure. This argument is mostly brought forward in favour of SOEs in sectors with a strong element of natural monopoly, purportedly difficult to address potential for abuse by private operators through regulation.[58]

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[58] Capobianco, A. and H. Christiansen (2011), "Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options", OECD Corporate Governance Working Papers,No.1,OECDPublishing.http://dx.doi.org/10.1787/5kg9xfgjdhg6-en-p.7, accessed on 15/05/2015

On the other hand, the Government seeks to maintain its public service obligations by shielding SOE's from open market competition. Sometimes SOEs are used as a tool for solving industrial policy issues such as unemployment. Thus, SOEs enjoy a level of political shielding from pressure groups or the general public. There are also fiscal revenues earned from SOEs that Governments fear loosing through competitive neutrality. The inability to transfer ownership rights will result in a number of advantages for SOEs such as not paying dividends, lesser incentives for efficient management as well as predatory pricing.[59]

It is worth noting though that corporate governance weaknesses may be a major reason for Government's failure to maintain competitive neutrality.[60] There are sufficient advantages for SOE's treated against rules of competitive neutrality. These include outright Government subsidization, concessionary financing and guarantees. Some Governments may have stringent public procurement rules but in practice they may continue enjoying post-corporatization preference in government tenders.[61]

II.2: The case of Rwanda

In Rwanda, competitive neutrality between corporatized SOE's and their private counterparts can be legally analyzed from the time of promulgating the law on competition and consumer protection.[62] Prior to September, 2012 there was no legal regime governing competition and consumer protection in Rwanda. It is noteworthy that the law specifically states that the Government, parastatals or companies in which the Government holds shares remain equally bound by the provisions of this Law, but with the proviso limiting the application of the law only to SOEs intended to produce, supply, distribute goods or provide any services on the market in Rwanda, which is open to participation by other enterprises. [63]

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[59] Ibid.p.7
[60] Op.cit.p.9
[61] Capobianco, A. and H. Christiansen (2011), "Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options", OECD Corporate Governance Working Papers,No.1,OECD Publishing. Http://dx.doi.org/10.1787/5kg9xfgjdhg6-en-p.6, accessed on 15/05/2015
[62] No36/2012 of 21/09/2012 relating to competition and consumer protection
[63] Ibid, article 3 but with the proviso limiting the application of the law only to SOE's intended to produce, supply, distribute goods or provide any services on the market in Rwanda, which is open to participation by other enterprises. The article also states that the provisions of this paragraph apply only if they are not contrary to other legal provisions.

The law prohibits anti-competitive practices in general including decisions and agreements meant to undermine, prevent, restrict or distort competition.[64] The law details certain practices that are generally prohibited to include written or non-written agreements designed to fix prices, hinder or prevent sales, keep potential competitors out of the market, prevent access to sources of supply or potential customers in the market.[65] The law prohibits collusive tendering or bid-rigging and any other arrangement in public procurement that may exclude, discriminate or undermine fair competition.[66]

Most of SOEs in Rwanda currently enjoy market dominance and as such there is a limited number of viable private business activities seemingly in competition with such SOEs. The case in point includes SOE's investing in public utilities infrastructure such as transport, energy, water and sanitation. The law prohibits abuse of such dominant position and as such prescribes measures for such abuses including ordering the abusive enterprise to sell some of its shares.[67] The law provides for a regulatory body to be established to regulate and ensure, inter-alia, competitive neutrality between corporatized SOEs and private competitors.

II.2.1: Competitive neutrality in respect of public procurement

The law on public procurement generally provides for competitive neutrality in public procurement.[68] The law governs procurement of all goods, works and services by a public/government entity except those items procured for purposes of national security or defence.[69]

Open competitive bidding is a generally accepted method under the law but there may be other exceptional methods conditionally applicable such as single sourcing/direct contracting. Single sourcing may be permitted if the total cost does not exceed the total amount determined by an

[64] Article 6 of Law No36/2012 of 21/09/2012 relating to competition and consumer protection
[65] Article 11 of Law No36/2012 of 21/09/2012 relating to competition and consumer protection
[66] Article 7 of Law No36/2012 of 21/09/2012 relating to competition and consumer protection
[67] Articles 9 and 54 of the law No.36/2012 of 21/09/2012 relating to competition and consumer protection
[68] Article 4 of law No.12/2007 of 27th/03/2007 on public procurement provides for fairness, competition, transparency, among others
[69] Ibid, article 2 & 3

order of the Minister in charge of public procurement, if the additional works that cannot be technically separated from initial tender. Under the procurement law, single sourcing cannot be justified by reason that the items are available only from a monopolist or that only one bidder has the capacity or the exclusive right to supply the goods or services.[70]

II.3 Regulating SOEs in Rwanda

Regulatory bodies establish and implement rules and regulations, monitor compliance and take part in enforcement activities. They play a key role in monitoring shareholders, management, board of directors, accountants, auditors, financial markets and institutions. Rules and regulations are also necessary to ensure there is proper balance between self-interest and the majority's interests. It is generally acknowledged that sound corporate governance is founded on sound legal rules and enforcement mechanisms.[71] Currently the subject of corporatization and corporate governance remains to be enabled by the Rwandan Company law.

II.3.1Rwanda Company law

In Rwanda, the law relating to companies was amended and passed under Law No. 07/2009. This law was an amendment of the Companies Act of 1988, and was aimed at addressing several shortcomings particularly in regards to corporate financial reporting, corporate structure, simplified business start-up and strengthened minority shareholder protection. The company law lays down the guidelines on company incorporation, distinction between a private limited company and a public limited company, capacity powers and validity of the Act, and shareholder rights and obligations among others.

Article 6 of the company law distinguishes a private limited company from public companies, restricting the rights to sell or transfer shares and limiting number of shareholders to only one

[70] Under article 56 of the law, the value of additional works does not exceed twenty per cent (20%) of the initial tender value. The additional works have to be subject to additional contract

[71] JULIAN M. MWIKA ,*Is it vital to have Corporate Governance Codes for Institutional Investors & Capital Markets? A Case Study of Rwanda* ,LLM thesis, Karlstad University,2012,retrivied at http://www.diva-portal.org/smash/get/diva2:538819/FULLTEXT01.pdf, accessed on 08/01/2015

hundred (employees not included). Private companies are prohibited from inviting the public to subscribe for any shares.

For the public or capital market dealers to buy shares in a company (whether state owned or private per se), such a company must first fulfill all requirements for listing on Rwanda Stock Exchange. The Company must be proved to be in compliance with minimum corporate governance and disclosure standards, being a sole pre-requisite for listing on Rwanda Stock Exchange.[72] In order for the issuer to appropriately release a company prospectus for review by the capital markets, the issuer's corporate governance should have been internally tested and proved to meet the pre-requisite standards.[73] Under the Rwandan Company Law,[74] the key requirements for companies to be registered shall include a memorandum of association, and articles of association. However, in practice the Registrar does not require a detailed memorandum and articles of association. Consequently, most information regarding corporate governance and disclosure standards remain lacking in most of companies incorporated but note yet listed on the Rwanda Stock Exchange.

Article 7 of Rwandan company law states that every company is a public company unless it is stated in its application for incorporation that it is a private company. Otherwise there is no clear definition of what constitutes a public company. On the other hand, SOEs may be considered to be public companies given the fact that they draw capital from public resources. In case of a public company, there are no restrictions on transfer of shares, on maximum number of members and on the invitation to the general public to subscribe for shares. Arguably, it follows therefore that all public companies including those listed as well as SOEs (listed or not) should be governed by a uniform code of corporate governance and disclosure standards.

In the last few years, Rwandan Government sold its shares in big companies like the largest brewer and soft drink maker *Brasseries et Limonaderies du Rwanda* (Bralirwa) where the government sold its 25% shares in (128,570,000 shares) through an IPO valued at US$ 29.5

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[72] Basing on clause 5 of Article 4 of the Law No.01/2011 of 10/02/2011 regulating capital markets in Rwanda, primary market transactions involve sufficient disclosure, periodic reporting that spur sound corporate governance as well as other prohibitions such as rules against insider trading in securities.
[73] Farazmand, A. *Public Enterprise Management: International case studies*, London: Greenwood Press, 1996
[74] *Op.cit*. Article14.

million. Likewise, 45% Government shares in *Banque de Kigali* (BK) were sold through the IPO on Rwanda Stock Exchange valued at US$ 62 million. Increasingly, a large number of private companies are being floated on the capital market, and ownership priority is being given to the local citizens. This has become an incentive to ownership of these companies by private as well as institutional investors. Since 1998, a total of 56 SoEs have been fully privatized, 20 in the process of privatization and 7 liquidated, bringing a total of 83 SoEs that the government has put through divestiture process.[75]

Given these trends on the capital market and divestiture process, SOEs have found a good recipe for implementing the acceptable corporate governance and disclosure standards. In Rwanda some SOEs are increasingly including independent and non-independent directors on their Boards. The key roles of the non-executive directors is to counter-weigh against the influence of the executive directors, ensuring that no individual or group can unduly exert influence on the board's decision.

II.3. 2.Law Regulating Capital Markets in Rwanda

The law regulating capital markets, also known as the Capital Markets Act was passed in February 2011, following the establishment of a capital market in Rwanda in March 2007. The law establishes a mechanism for controlling and supervising its activities with a view to maintaining acceptable standards and practices of market conduct. To ensure compliance with the capital markets rules issuers must conform with pre-requisite ethical standards including transparency. Punitive measures for breach include but not limited to written warning, financial fine, court injunction, withdrawal, suspension or termination of license, and disqualification from the profession. The Capital Markets Act in Chapter V states out stringent disciplinary measures against unethical behaviour by licensed personnel, as a deterrence against abuse of their power or acting in self-interest.

Other key provisions used to enforce ethical behavior are provided for under chapter VIII that deals with insider dealing and market abuse. Inside information, is described as price-sensitive information relating to capital market instruments that has not been made public, and if made

[75] Discussions with the Head of PPP Unit in Rwanda Development Board

public would have an impact on prices on the capital market. If a person possesses inside information by virtue of his occupation inside the capital market, they are strictly prohibited from using this information in any dealings. Furthermore, in ensuring that capital market is free of unethical practices, tough financial penalties are in place for persons or companies found breaching the standard practices.[76].

II.3. 3.Bilateral and multilateral investment treaties

The EAC have BITs, MOUs and other agreements mainly intended to anchor investment in general. However, formation of a single market for investment and trade is still hampered by inadequate policy support, legal barriers, cumbersome bureaucratic procedures, high risks, and relatively high investment costs.

It is, therefore, pertinent that Rwanda joins and inspires the EAC countries to formulate a single investment policy and investment code, thus creating a single investment corridor, minimizes investment risks and costs, while upholding standards of corporate governance.[77] The model EAC Investment Code needs to be graduated into a fully-fledged protocol or Act of the Community[78] to provide for a comprehensive framework operationalizing the principles.

Among the key principles not mentioned in the common market protocol is the principle for co-operation in implementing international standards and rules of corporate governance.

The guiding principles for investment regulation and liberalization towards a regional investment agreement for the EAC can be similar to those of the OECD's multilateral agreement on investment (MAI), of which authors[79] suggested the following:

(1) Promoting a more secure, predictable and transparent environment in which to plan and operate cross-border investments;

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[76] For example, persons operating without a license are liable to a jail term and a fine of between RwF 15,000,000 and RwF 50,000,000 (equivalent to US$ 25,000 to $83,000). Similar fines apply to companies that employ disqualified personnel, and those that issue misleading practices and statements. Offences of insider trading and market abuse carry a fine of up to $167,000 for the guilty party, and a jail term of up to two years.

[77] My own position but shared with Horn N & S Kr_ll , *Arbitrating Foreign Investment Disputes,* The Hague: Kluwer Law International, 2004, p.41.

[78] Article 29 of the EAC common market protocol providing for cross-border investment protection and implementing principles enshrined in the treaty for co-operation in investment and trade.

[79] Muchlinski P, F Ortino & C Schreuer, *the Oxford handbook of international investment law,* New York: Oxford University Press, 2008, p.24.

(2) Ensuring greater protection for investors and their investments;

(3) Promoting the progressive liberalization of barriers restricting the entry and conduct of foreign firms in domestic markets;

(4) Reducing or eliminating measures that distort trade and investment decisions and reduce allocative efficiency;

(5) Developing credible institutions and rules for solving potential disputes;...

(6) Ensuring adequate consideration for environmental issues, core labour standards and other related issues; and

(7) Ensuring that the relationship between the agreement and other related international instruments is clarified.

The EAC can be guided by these principles; we note however, that to negotiate a broad multilateral agreement was already a contentious issue during the Uruguay Round. The arguments being that the law on corporate governance has not sufficiently evolved and as such there are no generally acceptable and crystallized rules for sound governance of multinational corporations.[80] The Uruguay debate emphasizes on need to develop a crystallized set of corporate governance rules as pre-requisite for a multi-lateral investment agreement.[81]

II.3.4. Status of corporatization and corporate governance in Rwanda

From the above discussions, it is our argument that the success of corporatization has to be judged as a level of success in enforcement of corporate governance rules and market competitive neutrality. Legal restructuring should be considered in terms of how much it resolves the problem of control, accountability market efficiency and competitive neutrality in state owned enterprises. In Rwanda, the level of political accountability and efficiency seem to have vitiated any need for a well defined legal regime in support of corporatization.

[80] Manby B, *The price of oil: Corporate responsibility and human rights violations in Nigeria's Oil, New* York: Human Rights Watch, 1999.

[81] The Uruguay Round Table of the world Trade Organization focused on trade in Non-Agricultural products and the issues related to market access and investment protection.

II.3.4.1Legal rules governing public institutions[82]

All public institutions in Rwanda are regulated by law governing public institutions.[83] In 2007, another law passed to modify and complete the 2005 law. The modifications provide, *inter-alia*, for proper classification of public institutions. Public institutions are classified in any one of the following main categories in accordance with its mission[84]:

1° Public Institution for commercial or industrial exploitation;
2° Public Institution having the responsibilities of regulation and promotion in economic, social, and other activities as required by general interest;
3° Public Institution for scientific, technological and cultural research.

The modifications into the law emphasize the need to clearly define responsibilities of the Board of Directors, the management as well as those of all main organs of the Public Institution. Under the law, a classification includes possibility for the creation of hybrid institutions.[85]

An open-end is provided under the law in a way that gives flexibility in each law to determine any special matters relating to governance of each institution on merits.[86]

The law vests powers to control and direct all affairs of a public institution into the Board of Directors**.** Although, the term is used in lieu of governance is management, still the law clearly distinguishes Board responsibilities from management duties. The Board of Directors is responsible for decision-making, and have full powers to carry out the objective of public institution as stated under its enabling Law or by the performance contract referred to under the law on general provisions governing public institutions.[87]

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[82] Organic law No.14/2004 of 26/05/2004 establishing general provisions governing public institutions
[83] *Ibid*-Article 1
[84] Article 3 of the law No. n° 34/2007 of 13/08/2007 modifying and completing organic law No.14/2004 of 26/05/2004 establishing general provisions governing public institutions
[85] Article 4 of the law No. n° 34/2007 of 13/08/2007 modifying and completing organic law No.14/2004 of 26/05/2004 establishing general provisions governing public institutions.
[86] Article 11 of the Organic Law n° 14/2004 of 26/5/2004 establishing general provisions governing public institutions.
[87] Performance contract may be concluded between he institution and the Prime Minister from time to time

Members of the Board of Directors and members of any other necessary organs are appointed by a Prime Minister's Order. Their number and term of office is determined by the Law establishing the public institution. The emoluments of Board members are determined by the law establishing the public institution.[88]

There is limited legal independence in matters related to resources mobilization and corporate governance. The Law determines the authority competent to lay down the rules and regulations for the staff and the institution's organizational structure.[89] There is limited legal independence in budget management for public institutions.

The law states that each public institution determines modalities for adoption of and specifying modalities for budget management basing on peculiarity of its mission.[90] But such budget must be approved by the competent organ.[91] The law establishing a public institution has to set rules pertaining to auditing and financial reporting of the public institution.[92]
The law subjects a public institution to other public laws in so far as its relations with other public institutions are concerned.[93] These provisions do not mandate boards of public institutions to take control and be responsibility for the overall direction of the public institution. Consequently, Boards become vulnerable and as such loop-holes through invisible hands of stakeholders permeate and cause mismanagement of such institutions.

II.3.5. Upon corporatization, which is the law providing for governance of the SoE?

Rwanda Policy guidelines on management of Government Business Portfolio states that public enterprises operate within the framework of a variety of legislations including inter alia Law No. 06/2009 establishing general provisions governing public institutions and the law No12/2007 on

[88]*Ibid*-Articles 7.
[89] *Ibid*-article 8
[90] *Ibid* Articles 9 and10
[91] *Ibid*-Articles 9 and 10
[92] *Ibid*
[93] *Ibid*-article 16

public procurement and the relevant legislation under which each public enterprise was incorporated.[94]

On matter related to governance, the issue arising becomes whether public law remains applicable to any company evolving from a public institution. Yet each law repealing law establishing SoE only provides for company law as the applicable statute. In an attempt to deal with the issue we use case law to determine how Courts categorize the legal entities.

Prior to 2008, Courts were unable to devise certain tests to determine whether a contract concluded by a corporatized SoE is administrative in nature. However, in the recent case of *Gone Fishin´ v. Rwandan State*, the Supreme Court confirmed that three conditions must be satisfied if a contract is to be termed 'administrative, namely:[95]

a) A public institution must be present as a contracting party. This is known as 'the organic criterion', and it means that if a public entity is a party to the contract, then that contract is administrative in character, and public law is applicable. If no public entity is a party to the contract, private law is applicable.

b) The contract must seek to serve the general interest of the public.

c) The contract must be providing for special treatment vested in the public entity, giving special administrative discretion not found in the ordinary law. The first condition is essential, but the second and third conditions can be applied in the alternative (alternative criteria).[96]

In the aforementioned case, the main finding of the Supreme Court was stated as follows:

"From the above criteria, the Supreme Court found that a wide range of contracts fall under the category of administrative contracts. Such contracts include but not limited to public

[94] MINECOFIN,Policy guidelines on management of Government Business Portofolio,2010.

[95] *Gone Fishin´ v. Rwandan State*, Supreme Court, R.Ad.A 0006/07/CS, 19/02/2008 (unpublished)).
This decision invokes doctrines enunciated in the following French literature: J.-M. de Forges, *Droit Administratif*, University Press of France, third edition, 1995, pp. 30-31, R. Chapus, *Droit administratif général*, Tome 1, Paris, Montchrestien, fourth edition, 1988, pp.356-373, cited in *Gone Fishin´ v. Rwandan State*.

[96] *Gone Fishin´ v. Rwandan State*, Supreme Court, R.Ad.A 0006/07/CS, 19/02/2008 (unpublished)).
. This conclusion was reached from the following French literature: J.-M. de Forges, *Droit Administratif*, University Press of France, third edition, 1995, pp. 30-31, R. Chapus, *Droit administratif général*, Tome 1, Paris, Montchrestien, fourth edition, 1988, pp.356-373, cited in *Gone Fishin´ v. Rwandan State*.

procurement contracts. *"* [97] This means that more often than not such contracts are governed by public procurement law.[98]

II.4.0 Legal issues of post-corporatization of SOE's, privatization, public- private partnerships

In Rwanda, the law does not expressly address numerous post-corporatization issues, including lack of clarity as to whether the institution remains governed by public law, private law or otherwise. In Rwanda, privatisation process is governed by Law no 2 of 11 March 1996 on privatisation and public investment:[99] *"(...) the State can liquidate, let, restructure, or partially or totally cede a public establishment and/or other public enterprise or State service by way of presidential order or the law used for its creation:*

- if management of the enterprise has been failing;

- if the State wants to be free from a commercial or industrial enterprise;

- if the goal or purpose for which the enterprise was created has been fulfilled. (...)."

Basing on the Gone Fish case, concession of public assets is governed by Law no 2 of 11 March 1996, relating to privatisation and public investment,[100] which states: *"the State can cede a public establishment or other public enterprise, having a social or agri-pastural purpose, on the condition that the cessionary continues to strive for the goal initially set out for the public institution or public enterprise."*[101]

Concession of public domain' is similar to 'utilities concession' or 'public service concession', a kind of contract that delegates powers to a private body to run and manage a public utility or public service.

[97] Interview with the private auditor, conducted on February 10th, 2015.

[98] These procedures were first set out in the decree-law of February 1959 implementing the royal decree of 26 June 1959 on public procurement of work, goods and transport.[98] The decree-law did not, however, clarify procedures relating to procurement of services not related to transport. This decree-law was replaced by law n° 12/2007 of 29/03/2007 on public procurement

[99] Article 3 that: Law no 2 of 11/03/1996 relating to privatisation and public investment, in *0.G.* n° 6 of 15/03/1996.

[100] Law no 2 of 11/03/1996 relating to privatization and public investment, cited above.

[101] Article 4 of Law no 2 of 11 March 1996, relating to privatisation and public investment.

In both cases, the private entity is remunerated out of profits from running the public utility. The revenues may be generated from customers who may be required to pay a certain fee for the acquisition or use of services. This was the case for RWANDATEL[102] concession to TERRACOM.

The ELECTROGAZ management contract by Lahmeyer International signed in 2003 is another case in point.[103] The Hilton hotel group and the Eco-lodge in Volcanoes National Park have acquired land under the Public-Private Partnership (PPP).[104]Although concession of public utilities is common, it should be stated that the so-called 'Public-Private partnership' (PPP)[105] contracts emerging in Rwanda, do not have an underlying law.[106]

The fourth subcategory of contracts that bring public law into play encompasses subsidy agreements. Subsidies in Rwanda are two-folded, they may be granted by means of public decision or agreement. Firstly, there are subsidies which are granted by the government to public entities (and exceptionally to private entities), by way of public decision. Such subsidies typically involve the sponsoring of identifiable projects for public interest for example educational, scientific, health or environmental projects. Such an agreement takes the form of a public contract.

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[102] (Rwanda Telecommunication Company, a public establishment for landline telephones and internet services).

[103] Concession was terminated and ELECTROGAZ rebranded as EWSA (Energy, Water and Sanitation Agency, a public establishment for supply of electricity and water and also for sanitation) was conceded to private bodies. Current undergoing restructuring and corporatization[103]

[104] S. Ruburika, "After restructuring, a more efficient RDB emerges", *The Rwanda Focus,* accessed in http://focus.rw/wp/2010/10/after-restructuring-a-more-efficient-rdb-emerges/, accessed on 21/02/2015.

[105] According to the Public-Private Partnership Bill, a "'Public Private Partnership' or 'PPP' shall mean a long term arrangement between a Public Authority and a Private Partner which involves risk sharing and fiscal impact, and involves financing, design, construction, renovation, management, operation and/or maintenance or management of public infrastructure and/ or facilities and/or the provision of a public service or service that provides a benefit to the public. PPP shall include arrangements involving existing infrastructure and/ or facilities as well as new or greenfield facilities and concessions. It shall include projects where: (a) ownership of the Infrastructure Facilities is transferred to the Contracting Authority at the end of the Project, such as a build operate transfer (BOT) or refurbish operate transfer (ROT) arrangements; (b) transfer of ownership of the Infrastructure Facilities to the Public Authority at the end of the Project is not contemplated, such as a build own operate (BOO) arrangement; and (c) the Public Authority retains ownership interest in the Infrastructure Facilities throughout the Project."

[106] The bill on Public-Private Partnerships is not yet enacted. The state of public private partnership (PPP) in Rwanda stands on stalls of zero presence and what exist in the country are just concessions given to investors in some crucial sectors of the economy.

In *Agro-Consult sarl v. Rwandan State (Ministry of Agriculture)*,[107] before the High Court of Commerce, it fell to be decided whether the contract was private or administrative in nature. Basing its ruling on *Gone Fishin' v. Rwandan State*, the Court ruled that subsidy contracts are administrative in nature.[108]

II.4.1.Lack of a general law codifying the principles of governance of corporatized SoE's in Rwanda

In Rwanda, there is no general law codifying the principles of corporate governance, although certain legal instruments stipulate the application of some principles of good governance to certain specific matters. For example, the principles of equality before the law and the prohibition of discrimination are fundamental constitutional principles.[109]

Other principles can be found in other relevant legal instruments such as the principles of transparency, competition, economy, efficiency, fairness and accountability contained in the law governing public procurement.[110]

There is no clear line of interpretation of these principles in binding norms which can constitute a ground for judicial review of administrative action. Therefore, such principles enshrined in various statutes can be used to guide the development of specialized code of corporate governance binding on all corporatized SoE. In turn the code on corporate governance should provide for full mandate to Boards of State-Owned Enterprises to direct and control the conduct of such corporations representing interests of shareholders and the public in general. The appropriate principles to be enshrined in the code include the principles of share-holder equality before the law, transparency and prohibition of abuse of power and rules against conflict of interests.

In the governance of such entities, there are other principles to be emulated such as the principle

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[107] Agro-Consult is a private company, providing consultancy in agricultural matters.

[108] Agro-*Consult sarl v. Rwandan State (Ministry of Agriculture),* High Court of Commerce, RCOM A0126/08/HCC, 27/11/2008 (unpublished).

[109] Articles 11 & 16 Rwanda Constitution of 2003.

[110] Art. 4 of Law n° 12/2007 of 29/03/2007 on Public Procurement.

of legality, justification, proportionality, fairness, disclosure and accountability. Indeed a binding set of legal norms constituting a national law, for the proper regulation of public interest corporations. Once they are transformed into legal instruments, the principles can have a substantial legal effect on conduct of affairs of corporatized SoEs in Rwanda.

II.4.1.1.Governance challenges in State Owned Enterprises

According to OECD,[111] there are two major governance challenges common to all state owned enterprises. The first major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the enterprise. The second important challenge is to ensure that there is a level-playing field in markets where private sector companies can compete with state-owned enterprises and that governments do not distort competition in the way they use their regulatory or supervisory powers.

So far, there has not been any international benchmark to help governments assess and improve the way they exercise ownership of these enterprises, which often constitute a significant share of the economy. The shared experience of countries that have started to reform corporate governance of state-owned enterprises is that this is an important but also complex undertaking.[112]

Some countries and international institutions have developed some guidelines on how such dilemmas can be solved.[113] For example, they suggest that the state should exercise its ownership functions through a centralised ownership entity, or effectively coordinated entities, which should act independently and in accordance with a publicly disclosed ownership policy. The option of separating state's ownership from regulatory functions. It is argued that this would

[111] OECD, OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2005, p. 3, http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf, retrieved on 15/04/2015

[112] Tricker RI (ed.) *History of Management Thought: Corporate Governance* (2000), Aldershort, Burlington USA, Singapore, Sydney: Ashgate Publishing Limited.

[113] Sornarajah M, *The international law on foreign investment, Cambridge*: Cambridge University Press, 1994, p.22.

guarantee professionalism, accountability, competitiveness and efficiency in the governance of State Owned Enterprises (SOE).[114]

In the previous chapter we have analysed the Rwandan legal framework with the view to establish its inadequacies in domesticating international best practices on corporatization and governance of SOEs. Chapter is therefore devoted to discussion on ideal legal mechanisms supporting corporatization in Rwanda.

CHAPTER III. LEGAL MECHANISMS FOR ENHANCEMENT OF CORPORATIZATION IN RWANDA

As discussed in the previous chapter, State Owned Enterprises (SOEs) remain relevant in various economies around the world. But there is need for sufficient legal safeguards for a successful corporatization and corporate governance of such SOEs. In this chapter we explore the legal and institutional mechanisms that should effectively anchors the on-going corporatization of Rwandan SOE's.

III.1.Legal Mechanisms For An Effective Corporatization

On the basis of the above conclusions in the second chapter, it has been argued that there is weak legal foundation for an effective corporatization and corporate governance of SOE's in Rwanda. The key issue appears to be the need for enacting a specific law on corporate governance.

III.1.1.Strengthening the legal and regulatory framework

There is limited awareness of corporatization issues in Rwanda. Media should be encouraged to report on corporate governance issues as it is the most effective way of raising people's awareness of what is happening in corporations. The current initiatives by the government cannot be underestimated. Although there are laws relevant to corporate governance in general, the SOE governance post corporatization cannot be governed by such general laws. A specific law on

[114] Muchlinski PT *Multinational enterprises and the law, New* York: Oxford University Press, 2007, p.23.

corporate governance of SOEs would play a big role in corporate governance and market competitiveness of the same.

III.1.2.Ensuring an Effective Legal and Regulatory Framework for State Owned Enterprises

We have demonstrated in previous parts of this study the gaps and inconsistencies inherent in the current Rwandan legal framework governing SOE corporatization and governance. In our proposals of an ideal legal regime or corporatization of SOE in Rwanda, we remain guided by the OECD Guidelines on corporate governance of SOEs. The guidelines provide for transparency and consistency with the rule of law, among other factors, and ensuring that the corporatization framework is compatible with the legal framework in that:
"The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state owned-enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.[115] It has been argued that the complex legal and regulatory framework within which SOEs operate can be protected from abuse by among others, clear division of responsibility among authorities, streamlining of legal forms, and a coherent regulatory framework.[116]

The researcher is of the opinion that the above is recommended to keep the arm of the state from any temptation to interfere with the operations of SOEs. SOEs should operate on level terrain with other corporations; they should not be protected from proceedings by creditors.[117] Further, the guideline can also prevent the creation of monopolies by the state and encourage competition with the private sector. Monopolistic situations have been identified as one of the common weaknesses of governance and causes of compliance failure.[118]

115Anastassopoulos, J. P., Blanc, G., & Dussauge, P., *State-owned multinationals*. New York: Wiley, 1987,p.42.

[116] *Ibid.p42.*
[117] *Ibid., P.42.*
[118] T., Kyepa , Integrating National Oil Companies In The Corporate Governance Discourse: A Comparative Analysis Of The Norwegian State Oil Company (Statoil) And The Proposed National Oil Company Of Uganda,L.L.M.,University Of Western Cape,2011,retrieved on

III.1.3. Implementing OECD and CACG Principles of Corporate Governance in Rwanda

The OECD and CACG[119] principles of corporate governance originally adopted in 1999 and revised in 2004 have gained prominence as the standard measure for corporate governance the world over. Though the principles are not binding on its members, they offer a best practice mode. These principles have received due recognition by the World Bank, International Monetary Fund, and non-OECD countries, among others.

While the principles are said to apply to mainly publicly traded companies, they are also a good guide to non-traded companies, especially Corporatized SoE's.

III 1.4. Corporate governance as key pre-requisite for successful corporatization

This study departs from the debate on issues raised by camps debating on corporatization by introducing more central issues relating to corporate governance of a State-Owned Enterprise This study transcends the debate to establish the importance of laying down a crystallized set of legal rules underpinning successful corporatization. The Researcher agrees with assertion that the need for sound corporate governance in today's world is inevitable[120] due to the globalization of economies, financial and investment markets expansion, leading into an increasing convergence of originally separate initiatives in the field of corporate governance.[121] In the case of Rwanda, corporate governance rules have to be laid down for SOEs prior to corporatization to determine the extent of corporatization, separate public interests from commercial interests and ensure competitive neutrality in SOEs

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http://etd.uwc.ac.za/xmlui/bitstream/handle/11394/2899/Kyepa_LLM_2011.pdf?sequence=1p.70, retrieved on 20th/05/2015

[119] CACG refers to Commonwealth Association of Corporate Governance

[120] See Commonwealth Countries Association for Corporate Governance (CACG) guidelines, 1999,P.1.

[121] Coffee JC 'Dispersed Ownership: The Theories, the Evidence, and the Enduring Tension Between "Lumpers" and "Splitters", *ECGI Working Paper Series in Law* No.144/2010 electronic copy available at *http://ssrn.com/abstract=1532922* ,accessed 7 December 2014.

In the globalization era, traditional corporate governance laws and regulations are becoming increasingly challenged by circumstances and events of an international impact.[122]
The institutional investors, for instance, do insist on high standards of corporate governance in all companies as an incentive to drawing more capital for investment.[123]

On the other hand, public attention through high profile corporate scandals and collapses has forced governments, regulators and boards of corporations to carefully reconsider fundamental issues of corporate governance as essential for public economic interest.[124]

Experiences in public sector reform and privatization in many countries have set demands on State-Owned Enterprises (SoE) and government agencies to address standards of integrity expected of public service providers.[125] But also the rise of "ethical investors" requiring corporations to act in socially responsible manner in the communities in which they are operating in the areas of environment, health and safety, ethnic and community relations for their continued existence.[126]

Sound corporate governance rules and practices appear to be a special requirement especially in attracting FDI in public utilities sector of the developing economies. The term utilities refer to 'services of general public interest'.

In particular, states have a legal duty to ensure the availability of affordable and reliable utilities such as electricity, drinking water, waste-water collection and treatment, urban waste collection and treatment, transport, communication, environmental management, and technology

122*Musacchio, A., & Lazzarini, S. G., Reinventing state capitalism: Leviathan in business, Brazil and beyond*. Cambridge, MA: Harvard University Press, 2014,p.24.
[123] *Ibid.*
[124] For instance the enactment of Sarbanes Oxley legislation in the United States which introduced many new requirements in the New York Stock Exchange listing rules after the collapse of Enron &WorldCom. Major developments in corporate governance such as corporate codes were effected during the past two decades.
[125] For example the OECD and CAGC guidelines provides for both principles to be followed by public and private companies. The King III Report on Corporate Governance for South Africa also applies to all companies and organizations (Accessed on http://www.ecseonline.com/PDF/CACG%20Guidelines%20-%20Principles%20for%20Corporate%20Governance%20in%20the%20Commonwealth.pdf).
[126] See King ME A *Report on Corporate Governance* (2009) (King III) principle 1.2. retrieved on 15/04/2015

infrastructure, with an acceptable level of quality.[127]To avoid failure of corporatization and governance of SOEs, the Rwanda law should clearly split between public interest and political motives from commercial motives. But studies have also shown that enterprises that are state owned *per se* are generally known for poor management when judged as providers of utilities.

We therefore recommend Public-Private Partnership as an option: In the recent past, a 'hybrid' mode of provision arose in Europe and in several countries in South America mixed (government) companies are institutionalized under a public-private partnerships (PPPs) model where the public and private partners are equity owners[128]. Both public and hybrid types of companies are legally classified as State Owned Corporations. For such mode of corporatization to be enforced in Rwanda the law on public private partnership should be enacted, thanks to the on-going PPP legislative process.

The new drive to corporatize the enterprises is meant to enable them function as public or hybrid- Corporation with higher capacity to deliver, attractive to private investors, qualifying for listing on securities market and as such attractive to FDI.[129] .The codified rules on corporate governance would deter or reduce the level of influence and interference purported by public officials on the management of such enterprises for personal and political gains.[130]

III.2. INSTITUTIONAL MECHANISMS

The following solutions were proposed for a better performance of States Owned Enterprises through corporatization.

III.2.1. Avoiding governance failure of State Owned Enterprises in Rwanda

As pointed above, the Government needs to adopt appropriate policies, and laws to anchor governance of corporatized SOEs. In so doing the potential for "market failure" or management failure of such enterprises will be avoided. The government of Rwanda should adopt appropriate

[127] Nuno Ferreira da Cruz & Sanford V.Berg: Managing Public Utilities; Lessons from Florida-p.3
[128] *Ibid-p4*
[129] *Ibid*-p4
[130] King, E., Mervyn ,et al, "*The King Report on Corporate Governance",* Institute of Directors of Southern Africa: Johannesburg, November 1994.

policies and laws on governance autonomy, accountability, investment, prices, financing, affecting management efficiency, effectiveness and capacity of SOEs[131].

The laws in place in Rwanda are either general or not specific to corporatization and governance and their scope do not envisage corporatization and SOE governance[132].

III.2.2. Re-inventing State Owned Enterprises in Rwanda

Globally, it is estimated that 28 out of the 100 largest companies in emerging markets have a government stake [133]and that state participation in the marketplace has generally not seen any significant retreat, except in a few countries with a heavy socialist legacy. At the outset, the creation of state-owned enterprises has generally been motivated by challenges such as high natural barriers to entry in certain sectors, capital markets failure, and the lack of incentives for the private sector to perform certain activities.

In emerging markets in particular, SOEs have been and continue to be utilised as a motor for industrial development, provision of key goods and services, generation of employment and a variety of other objectives, some purely commercial, others social in nature. [134]In recent years, this growth in the functions SOEs are charged with reflects a level of disappointment with laissez-faire approaches on the one hand, and the success of some economies such as Singapore or China in using SOEs as a motor of capital markets development, sectoral policies, infrastructure provision and even poverty reduction on the other.

Reinventing SoEs in Rwanda should begin with a comprehensive performance review and the formulation of a government strategy for reform. Governments are unlikely to be successful in

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[131] Basu P. K. and Nove, Alec *"Public Enterprise Policy on Investment, Pricing and Return*": City Press Kuala Lumpur, 1979.

[132] In earlier stages of SOE development it was felt necessary to delink the impact of managerial decision making by governments as policy- makers – but governments continue to enjoy over-riding strategic powers of appointing the SOE Board, fixing their terms and remuneration, deciding on all new investments and expansion, fixing prices, approving contracts and purchases, etc.

[133] The Economist, January, 21st 2012, Special Report; State Capitalism's global reach. How State Enterprise is spreading. Available on web:www.economist.com/node/21542925 titled New masters of the Universe. China's 121 biggest SOEs, for example, saw their total assets increase from $360 billion in 2002 to $2.9 trillion in 2010 (though their share of GDP has declined). And it has been given an extra boost by the 2007-08 financial crises: in 2009 some 85% of China's $1.4 trillion in bank loans went to state companies.

[134]OECD, State-Owned Enterprises in the Middle East and North Africa Engines of Development and Competitiveness?, http://www.oicexchanges.org/docs/third-meeting-istanbul/mena-soes-eng.pdf, retrieved on 15/04/2015

restructuring public enterprises unless they develop a strategy that sets out a clear vision for how SOEs are expected to contribute to development and defines clear missions and performance criteria for each public enterprise[135].For example, the vision for reform of South African SoES at the macro-economic level was to attract foreign direct investment, contribute to the reduction in public borrowing, and assist the development of an economy that promoting industrial competitiveness and growth and increased domestic savings.[136] Any country seeking to reform public enterprises, strategy formulation should be preceded by an assessment of the performance of the public enterprise sector carried out by a government commission or agency that can identify SOE objectives, assets, and resources; assess their financial assets and liabilities; evaluate their performance in meeting their objectives; and demonstrate their contribution to economic and social development.[137]

The Government of Rwanda in undertaking public enterprise reform must often revise the legal framework to clarify the ownership relationships between the state and SOEs, impose internationally accepted accounting and financial reporting standards, and outline governance options[138].

III.2.3.Legal rules for an Effective Corporatization Framework

From the previous discussion of the various models of corporatization, there is an need to enact a legal framework underpinning the promotion of transparent and efficient markets, consistent with the rule of law and clearly articulating the division of responsibilities among the different supervisory, regulatory and enforcement authorities.[139] The economic system, the legal regime and the relevant institutions should all be aligned to the desired corporate governance

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[135] *Ibid.*

[136] Sivi Gounden, "Restructuring of State Owned Enterprises – A Critical Element of Economic Restructuring in South Africa," Leadership Center, University of Kwazulu-Natal, South Africa, March 7, 2001.

[137] U.N, Department of Economic and Social Affairs Division for Public Administration and Development Management, Public Enterprises, Unresolved Challenges and New Opportunities, p.30; retrieved at http://www.unpan.org/Portals/0/60yrhistory/documents/Publications/Public%20Enterprises%20-%20Unresolved%20Challenges.2005.pdf), on 25 May,2015

[138] Gabriel Roth, *the Private Provision of Public Services in Developing Countries*, New York: Oxford University Press, 1987.

[139] Organisation for Economic Co-operation and Development, 2004, p.59.

framework. The researcher shares the view that good public sector governance is a necessary condition for a successful corporatization and corporate governance of SOEs.[140]

Corporatization of SOEs and enacting corporate governance law coupled with public awareness would help to nurture corporate culture in Rwanda. In turn, the FDI flow would increase due to high investor confidence. For example, a set of guidelines and legally binding principles were developed to represent the Commonwealth approach to corporate governance. The guidelines and principles have enabled numerous countries to develop their national codes of corporate governance tailor-made to suit their requirements[141]. As regulatory barriers between national economies are increasingly removed and global competition for capital increases, the FDI will follow the path to those countries and corporations that have adopted efficient governance standards. The standards include an acceptable level of investor protection and board practices as well as satisfactory accounting and disclosure standards[142].

CHAPTER IV: GENERAL CONCLUSION

Firstly, from the above analysis it is evident that corporatization has more inherent advantages than disadvantages. Corporatization may enhance value for money, efficiency and accountability in the management of Public Investments.

Secondly, we have demonstrated that the on-going corporatization of SOE's in Rwanda follows general laws referred to in this study. The existing laws do not adequately and critically provide for a set of legal norms and standards of corporate governance specific to State Owned Corporations. In our considered view, a successful corporatization of SOE's must be preceeded by a specific law setting governance rules. The references provided in this study lay an emphasis on the need for a clear legal regime to underpin corporatization of Rwandan SOEs. The legal framework is required to align all basic principles of corporatization as cited in this study. Such a legal framework should seek to give legal effect to the existing public investment policy.

140 Sauvant, K. P., Sachs, L., & Schmit Jongbloed, W. P. F. , *Sovereign investment: Concerns and policy reactions*. New York: Oxford University Press, 2012,p.26.

[141] Commonwealth Business Forum Resolution, October,1997

[142] Ibid

Thirdly, we have demonstrated in this study that SOEs corporatization and public sector governance reform are quite inter-linked; they are not mutually exclusive. Therefore the success of corporatization in Rwanda has to be predicated on public sector reform initiatives given that there is a linear relationship inter-se.

Fourthly, we find that the incentives for Rwanda's SOE sector reform initiatives are not drawn from any "foreign best-practice". However the corporatization process responsive to an increasing demand for efficiency, accountability, value for money and commercialization/marketization of utilities. It is legally unclear as to the degree of "publicness and competitive neutrality" of SOE's.

Fifthly, we note that corporate governance reform has to guide and determineof the extent of SOE reform and development in Rwanda. Such reforms should be legal ring-fenced through codification of Rwanda's law on public investment, corporatization, divestiture and governance of SOEs. The fact that Rwandan SOEs do not have a clear legal framework for their corporatization makes it very difficult for the entities to be assessed for optimal levels set for their performance. The draft bill on public institutions, completely keeps SOEs out of its scope. As discussed above, OECD principles have been recommended by several notable organizations, such as the World Bank for use in molding an ideal governance structure.

IV.1: RECOMMENDATIONS

In light with our findings in this study, we are of the view that the following recommendations can improve the legal framework of corporatized state-owned enterprises in Rwanda.
Firstly, the law proposed to govern public investment, corporatization, divestiture and corporate governance of SOEs should ensure a level-playing field in the Rwandan market. State-owned enterprises and private sector companies should be equally enabled to compete to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.

Secondly, under the proposed law separation between the state's ownership function and state's regulatory and supervisory functions over the corporatized entities as well as the market should be clear. The benchmark for this could be French model where corporatized entities relate with Government as partners, minimizing risk of agency problem arising in the governance of such entities.

Thirdly, the Government should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Corporatized SoE should cease to function as legal and administrative agents of public sectors line actors. For example, State should allow creditors to press their claims and to initiate insolvency procedures.

Fourthly, any obligations and responsibilities that an SOE is required to undertake beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner. This would reduce political influence on the conduct of SoE's.

Fifthly, SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.

All in all, it should be pointed out that this study has employed a qualitative research method; it highlights general issues which to a certain extent are valid in Rwanda.

Further research is needed so as to involve a quantitative practical survey, particularly with respect to listed and non-listed firms to provide a strong base for generalization over a wide range of companies and give a firm practical test.

The recommended research can also be extended by practically surveying some companies' practices in Rwanda and others from developed countries to compare the findings. This will generate additional knowledge on the general development of corporate governance in Rwanda.

Another area that requires further research is the accountability of the corporate business to society. The international community is emphasising on corporate citizenship and corporate responsibility. The role that corporations play in the society they operate in is of utmost importance for their continued existence. Therefore the research in this area should provide insight into corporate governance practices and accountability in Rwanda. Appropriate corporatization is required for all type of corporations.

Therefore, it should not be limited to the industrial corporations and listed /public companies only. Research on other sectors of the economy such as the financial sector, public sector, private sectors and executive agencies is also needed. This is expected to provide additional insights on corporate governance practices in Rwanda. Additional research in all areas mentioned above would contribute significantly to the overall business sector reform and state-owned enterprises reform in particular.

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Law No.13/2013 modifying Law No.39/20[01] of 31st/09/2001 establishing Rwanda Utilities Regulatory Authority)OG no.14bis

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