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ORDINARY SHAREHOLDERS' RIGHTS PROTECTION IN BOTSWANA

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About BIDPA

The Botswana Institute for Development Policy Analysis (BIDPA) is an independent trust, which started operations in 1995 as a non-governmental policy research institute. BIDPA's mission is to inform policy and build capacity through research and consultancy services.

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EXECUTIVE SUMMARY

This policy brief seeks to examine the institutional frameworks that exist in Botswana to protect the rights of ordinary shareholders. Findings reveal that, in Botswana, existing institutional frameworks are not adequate to protect ordinary shareholders' rights. Furthermore, the Choppies case study shows that the lack of adherence to corporate governance standards resulted in loss of wealth by shareholders. The brief suggests that the existing institutional frameworks should be reviewed to ensure adequate protection of ordinary shareholders' rights.

INTRODUCTION AND BACKGROUND

Internationally, it is recognised that the level of investors' confidence in any given market is determined by the strength of the institutional framework (Jensen and Meckling, 1976). Lack of shareholder protection in the local market may result in capital flight to countries where markets provide such needed security and confidence. Generally, shareholders' rights include, but are not limited to, entitlement to view financial statements of the company, voting and the right to sell and buy securities at their will. Issues of law enforcement and corporate governance should be closely monitored and evaluated to ensure that shareholders' rights are protected at all times. Specifically, shareholders must be protected from expropriation (La Porta, et al., 2000), which arises from the agency arrangement made between shareholders (principals) and company managers (agents). Expropriation of firm profits, especially by managers of listed firms, in alignment with their own interests, is a quintessential example of the violation of the expected relationship between firm principals and agents. It mostly arises when principals are inadequately protected by legal and regulatory institutions from the malicious acts of agents. This is mostly true when laws and regulations discriminate between majority and minority (ordinary) shareholders. Majority shareholders (which may include managers) appear to be more protected than the minority shareholders based on their voting and/or decision-making power.

In Botswana, there are three main institutions that are tasked with investors' rights protection; the Non-Bank Financial Institutions Regulatory Authority (NBFIRA), Botswana Stock Exchange (BSE) and Companies and Intellectual Property Authority (CIPA). Corresponding laws and regulations that exist to protect shareholders' rights in Botswana include: the Securities Act of 2014 (NBFIRA, 2019), Companies Act of 2003 (CIPA, 2019), Code of Best Practice on Corporate Governance (BSE, 2019a), BSE Equity Listings Requirements (BSE, 2019b) and Guidance for Listed Companies (BSE, 2019c). Although these institutional arrangements exist in Botswana, World Bank Group (WBG) (WBG, 2019) ranked Botswana poorly compared to its counterparts in the region on issues of minority shareholders' protection. For instance, Botswana's score of 60 was below the scores for South Africa, Mauritius and Kenya, of 80, 78 and 92, respectively. The problem identified by this study is that ordinary shareholders in Botswana are mainly exposed to risks of losing their investments, partially or entirely, in case of non-compliance to regulatory requirements as shown by the reduction in Choppies' stock price from P1.20 to P0.40 between years 2012 and 2018.

ANALYSIS

Legal and Regulatory Framework Pertaining to Shareholders' Rights Protection

The Companies Act includes minority shareholders under section 164 subsection (1) which states *"any member of a company, who complains that the affairs of the company are being conducted in a manner that is oppressive to some part of the members (including himself), may make an application to the court for an order under this section."* Whilst the Companies Act gives shareholders the right to protest against mistreatment by company agents by way of litigation, minority shareholders are disadvantaged since they usually do not have sufficient financial (or voting) power to petition against majority shareholders (who include agents). This provision does not acknowledge that the ordinary investors would have lost some wealth when non-compliant companies are delisted or suspended from the BSE. It would be an added protective measure for the Act to have included a section on strengthening corporate governance structures within companies, with further monitoring provisions that would enforce compliance of domestic companies to the highest corporate governance ethos. Notwithstanding, Part 3, Section 10, subsection 3 of the Securities Act shows that punitive actions such as fines and penalties may be taken by the BSE against non-compliant listed companies in pursuit of protecting shareholders' rights.

However, there are some problems of capacity shortages and structural deficiencies in the regulatory framework to efficiently protect shareholders rights. For example, the interviews revealed that, at NBFIRA there is only one qualified officer who is dedicated to the surveillance of the capital market activities. Additionally, there is no electronic surveillance system at NBFIRA that would automatically detect suspicious trading activities on the local bourse. The industry players are of the view that the legal instruments are inadequate in protecting ordinary shareholders in Botswana. For instance, Companies Act, Section 98, subsections 1 and 3 gives the power of convening an extraordinary general meeting and voting during that meeting, to the majority shareholders over ordinary/ minority shareholders. Moreover, they argue that market regulators lack independence, work in silos and that they appear to compete with each other. Structurally, NBFIRA is a parastatal under the Ministry of Finance and Economic Development, charged with regulating the entire spectrum of non-banking financial institutions; including the capital and stock markets, hence there is a serious resource constraint to discharge such a huge task.

Lessons from Other Jurisdictions

In contrast, the United States' (US) government established the Securities and Exchange Commission (SEC), as an independent primary regulator of the

securities market. Unlike NBFIRA which has a broader mandate of regulating all the non- banking financial institutions, the SEC's sole mandate is to protect investors, maintain fair, orderly and efficient markets. This sole mandate of protecting investors is emboldened by legislative instruments (Securities Act of 1933 and Securities Exchange Act of 1934) that allow for prosecution of firms that are non-complaint by the SEC's Division of Enforcement (SEC, 2012; SEC, 2018). Furthermore, under the securities regulation landscape in the US, there is the Financial Industry Regulatory Authority (FINRA) whose task is to solely deal with promulgation of rules that govern broker-dealers and other investment professionals. There is also the Securities Investor Protection Corporation (SIPC) which was established by an act of Congress. Its mandate is to restore investors' cash and securities when their brokerage firms fail. It is important to note that both FINRA and SIPC exist as independent institutions from the SEC, with the SIPC being a non-profit. The main differences of our securities' regulatory environment with that of the US is that, in the US, exchange houses are left as exchange houses and do not have any primary regulatory authority aside from their listings' requirements. Second, the regulation of the entire financial market industry is not left to one organization (as is the case with NBFIRA).

In Kenya, the Capital Markets Authority (CMA) is an independent public agency which was established by an act of parliament. It is charged with the responsibility of supervising, licensing and monitoring the activities of capital market intermediaries. One of its regulatory functions as provided by the act is the promotion of investor education and public awareness and the consequent protection of investors' interest. Unlike Botswana, Kenya's main regulatory authority is independent, as in the case of the United States.

Choppies Case Study

Choppies is a Botswana listed company that previously traded as CHOPPIES on the BSE and CHP on the Johannesburg Stock Exchange (JSE). Choppies listed on BSE in 2012 and its initial public offering was P1.15. In 2018, Choppies failed to hold its annual general meeting. It was later reported through the local media in Botswana (Mmegi, 2019; Sunday Standard, 2019; Gazzete, 2019; Gazette, 2019b) that there was some misappropriation of profits by Choppies' Chief Executive Officer (CEO) and some accounting irregularities regarding bulk sales and inventory. Apparently, the CEO loaned other related companies some monies without the Board's or the shareholders knowledge. However, this was expectedly refuted by the Choppies Group CEO during the interview. In March 2018, Choppies failed to publish its financial statements; contravening section 3.21(b) of the BSE Listing Requirements. Johanesburg Stock Exchange then suspended Choppies for failure to release financial statements. This led to Choppies share price falling from P1.25 to P0.40 in September 2018. In November, 2018, the BSE followed suit, suspending the trading of Choppies shares because of the failure to comply with BSE Listing Requirements. Court cases on insider trading were then launched against the Choppies' CEO, who is the largest single majority shareholder. Furthermore, the Choppies Board of Directors suspended the Choppies' CEO. Nonetheless, the CEO won the court case. Thereafter, the CEO was reinstated by the majority shareholders (including management).

This case illustrates non-compliance to corporate governance standards by Choppies management. De-listing statute within the BSE Listing Requirements in section 13.2 subsection (a)(iv), states that if a company has been suspended and does not rectify its transgression in order to comply within 6 months of suspension, then the Listings and Trading sub-committee can take action to de-list the firm. To date, more than 6 months after suspension, it is not yet clear why Choppies has not been de-listed from BSE nor its suspension lifted. Furthermore, the rights of the minority shareholders were not legally protected when the CEO was reinstated by the majority shareholders (including himself). The losses incurred by ordinary shareholders are therefore taken simply to be part of the inherent risks of stock market investing, even though they are a result of broken "rules of the game" – weak adherence to corporate governance standards by Choppies managers.

POLICY IMPLICATIONS

There is an opportunity for expropriation and breach of corporate governance standards by listed companies in Botswana. Therefore, there is need to: (i) Review laws and regulations to adequately address the issue of ordinary shareholders' rights protection in Botswana and to ensure that non-compliance to requirements is punished without delay to avoid loss of wealth to shareholders; and (ii) Empower NBFIRA with sufficient resources to effectively and efficiently regulate the securities market.

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