

**LEGAL INTERSECTION BETWEEN CORPORATE GOVERNANCE AND  
BANK FINANCING OF COMPANIES IN BURUNDI**

**BY**

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## **DECLARATION**

I declare that this thesis report is the work of Nzeyimana Chadia alone, except where due acknowledgement is made in the text. It does not include materials for which any other university degree or diploma has been awarded.

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## **APPROVAL**

I certify that I have supervised and read this report and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate in scope and quality as a thesis in partial fulfillment for the award of Degree of Master of Laws of Kampala International University.

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## **LIST OF STATUTES AND INSTRUMENTS**

### **BURUNDI**

Bank procedures and credit policy of the BCB (Procédure bancaire et Politique de crédit de la BCB)

Circular N ° 01/06 relating to the minimum capital of banks and financial institutions issued pursuant to Decree-Law No. 1/017 of 23 October 2003 regulating banks and financial institutions

Investment Guide – Burundi

Investor's Guide to Burundi of March 2012

Law No. 1-002 of 6 March 1996 on the company code amended by the company code of 2011

Law n ° 1/017 of 23 Octobre 2003 on the regulation of banks and financial institutions

Law n ° 1/09 of 30 May 2011 on the code of private companies and public participation

### **REGIONAL LEVEL**

King IV Report on Corporate Governance for South Africa 2016

Financial Institutions Act of Uganda, Chapter 54 of 14 May, 1993

### **INTERNATIONAL LAWS**

Code of corporate practices and conduct

G20/OECD Principles of Corporate Governance 2015

Guidelines on Credit Risk Management, Credit Approval Process and Credit Risk Management

Loi 2010-1249 du 22 octobre 2010 de régulation bancaire et financière, LEGIFRANCE

OECD Principles of Corporate Governance 2004

The Cadbury code : Report of the committee on the financial aspects of corporate governance, 1 December 1992

### **LIST OF CASES**

Aaron's Reef v. Twiss (1896), A.C. 273, 287

Dixon v. Country wide Fin. Corp., 2009 U.S. Dist. LEXIS 101451 (S.D. Fla. Oct. 16, 2009)

U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C., 864 A.2d 930, 943 (Del. Ch. 2004).

## **ABBREVIATIONS AND ACRONYMS**

<b>ABEF</b>	Association of Banks and Financial Institutions
<b>AFI</b>	Alliance for Financial Inclusion
<b>BANCOBU</b>	Banque Commercial du Burundi
<b>BBIN</b>	Burundi Business Incubator
<b>BCB</b>	Banque de Crédit de Bujumbura
<b>BIA</b>	Burundi Investment Authority
<b>BRB</b>	Banque de la République du Burundi
<b>CFCI</b>	Federal Chamber of Commerce and Industry
<b>CNRS</b>	Centre National de la Recherche Scientifique
<b>CRDC</b>	Cooperative Rural Development Bank
<b>EAC</b>	East African Community
<b>EU</b>	European Union
<b>FIGA</b>	Impetus Guarantee and Support Fund
<b>GTZ</b>	German Technical Cooperation Agency
<b>IBB</b>	Interbank Burundi
<b>IDEC</b>	Economic Development Institute of Burundi
<b>KCB</b>	Kenya Commercial Bank
<b>MFI</b>	Microfinance Institution
<b>NFIS</b>	National Financial Inclusion Strategy
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>SME</b>	Small and Medium Enterprises
<b>USD</b>	United States Dollar

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## **ABSTRACT**

*In Burundi, corporate governance is a new concept in the legal perspective; we find a poor legal system and reluctance to enforce the laws. The end result is that we find many companies in a bad position and in their downfall they also involve banks that give them debts which they are unable to repay. The main objective of this study is to analyze whether the laws governing bank financing can, in one way or another, influence the way corporate governance is done in companies.*

*What the researcher has found is that through the system of monitoring, bank finance influences corporate governance in Burundi but also that though bank financing plays an important role in corporate governance, the law in Burundi is extremely weak and enforcement inadequate. This to mean that there is still a long way to go, whether in the financial sector or in the arrangements of the regulatory framework before we reach effective corporate governance in Burundi. The main recommendation is that after improving the legal and institutional framework of corporate governance, coaching is necessary to help to reach a good practice in that domain. Also, as banks are a part of the corporate governance system, they should be able to ensure compliance with core company law obligations.*

## CHAPTER ONE

### GENERAL INTRODUCTION

#### 1.1 Background to the study

A company, according to the black law dictionary is "A society or association of persons, in considerable number, interested in a common object, and uniting themselves for the prosecution of some commercial or industrial undertaking, or other legitimate business".<sup>1</sup> This definition has however omitted the concept of "one Person Company". In other words, a company may also be constituted by only one person.

Companies have different ways to find the necessary funds to keep their company working; like; investment banks, insurance companies, finance companies, investment managers and other companies that profit from the creation and flow of money; Banks are just one part of the world of financial institutions.<sup>2</sup> As financial intermediaries, banks stand between depositors who supply capital and borrowers who demand capital.<sup>3</sup> If we consider the way commerce and individual wealth rests on healthy banks, banks are also among the most heavily regulated businesses in the world.<sup>4</sup> As we see it in this article of evolution of banking, banks are not the only financial sources available for investors; however, the researcher chose to focus on it because it constitutes the main source of financing in Burundi.<sup>5</sup>

Loan contract represents a form under which interest and principal payments by the borrowers are fixed by the agreement. The borrower is interested in increasing the riskiness of investments to get the highest possible returns net of interest payments, the lender is interested in getting the fixed payments without participating in the extra profit but fully bears most of the costs in case of failure. This kind of behavior leads to moral hazard problems. To mitigate the moral hazard problem, banks

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<sup>1</sup> Black's Law Dictionary, Legal Dictionary 2nd Ed. available on <https://thelawdictionary.org/company/>, accessed on 6<sup>th</sup> may 2018.

<sup>2</sup> The Financial Institutions Act, Uganda 2004, s 3.

<sup>3</sup> Nino Papiashvili, 'Monitoring by Banks as Corporate Governance Mechanism' (Ulm University Institute of Finance, 2003) 3.

<sup>4</sup> (To learn more, see The Evolution Of Banking.) Read more: The Banking System: Introduction.

<sup>5</sup> Deloitte & Touche, 'Burundi Economic Outlook' (2016 report) 10.

monitor the borrowers and sometimes impose collateral requirements on them.<sup>6</sup> Here we understand that the act of monitoring has a great importance for banks because it increases the possibilities of recovering the credit granted. It is also helpful for companies because it helps them to improve their corporate governance.

Bank monitoring is of big advantages to stakeholders in the way that the decision to lend signals the quality of the borrower to other stakeholders. Banks obtain private info ex-ante and their decisions to lend translate into good value and higher creditworthiness of the borrowers; it also reflects the value of future bank monitoring over the life of the loan.<sup>7</sup> In few words, this means that bank monitoring contributes increasing the trust that people have for a given company. Stakeholders will be convinced of the good situation of the company because the Bank can't grant a credit to a company which financial situation is not good. Corporations also benefit from this because they find here the motivation to improve their corporate governance.

This dissertation seeks to explore the governance role of bank financing in Burundi. It attempts to contribute to existing literature on alternative mechanisms of corporate governance by exploring the extent to which informal mechanisms of control, in particular, bank finance, shapes and influences corporate governance in Burundi; this to show the importance of Law and legal institutions in shaping corporate governance.

In Africa, Institutional reform was seen as a precondition for the success of economic reforms.<sup>8</sup> Ultimately, it is in this context where political adjustment is associated with economic adjustment that there has emerged the paradigm of good governance very peculiar to post-colonial Africa in order to "correct distortions of its economy and, consequently, create a climate conducive to the revitalization of its growth".<sup>9</sup>

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<sup>6</sup>Nino Papiashvili, *ibid.* 3.

<sup>7</sup> *Idem.* 6.

<sup>8</sup> Siméon Barumwete, *Bonne Gouvernance et Développement au Burundi : Realites et Perspectives* [Université du Burundi] trans. (*Good Governance and Development in Burundi: Realities and Perspectives* [University of Burundi]), (05/03/2014)1.

<sup>9</sup> *Idem.*

Burundi is an East-Central African country. Its capital is Bujumbura and it is bordering Rwanda, Democratic Republic of Congo and Tanzania. It has an area of 10,747 sq. m. (27,834sp.Km) and a population of 6,9 million. Its Official languages are Kirundi, French and very recently English. Burundi is a Republic with Presidential Democracy, Senate, and National Assembly, that is its form of government. The frequency of ethnic clashes and others increased and went on until now.<sup>10</sup>

Burundi was once part of German East Africa. Belgium won a League of Nations mandate in 1923, and subsequently, Burundi, with Rwanda, was transferred to the status of a United Nations trust territory. In 1962, Burundi gained independence and became a kingdom under Mwami Mwambutsa IV.<sup>11</sup>

Janvier, Léonce, and Prime state in their book, the Current banking sector situation. It comprises 8 commercial banks, including Diamond Trust Bank which opened in 2009. They add that banking sector is highly dominated by two mature banks, the Banque de Crédit de Bujumbura (BCB) and the Banque Commerciale du Burundi (BANCOBU) accounting for a commanding share of the market. The two banks account for 43 percent of deposits, 42 percent of total assets, and 42 percent of credit allocated in 2008. Together with Interbank Burundi (IBB) created in 1992, the three largest banks represented 76 percent of total assets, 74 percent of credit, and 79 percent of deposits in 2008, as well as most bank branches in the country.<sup>12</sup>

All this rose in the researcher, the need to analyze what is the actual economic situation in Burundi. The researcher specifically addressed his concern on evaluating the development perspectives and challenges facing the country and the role the Bank can play, in close collaboration with the Government of Burundi (GoB) and development partners, in supporting the country to meet its development objectives. The researcher has also put its interest in analyzing the level of corporate governance in Burundi and how by good corporate governance, the society can benefit and improve its standard of living.

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<sup>10</sup>Burundi, Geography, Government, History, accessed at <http://www.infoplease.com/country/burundi.html>, on the 13th March 2018.

<sup>11</sup>idem

<sup>12</sup>Janvier D. NKURUNZIZA, Léonce NDIKUMANA, Prime NYAMOYA, *the financial sector in Burundi* [NBER AFRICA PROJECT] (April 2011) 13.

Many reasons have made it difficult for Burundi to achieve national development goals, especially poverty reduction.<sup>13</sup> Among them is the post-independence period in the country that has been characterized by low and volatile growth. Factors that account for the sluggish and volatile growth range from physical constraints (e.g., Burundi is land-locked) that raise the costs of production and trade, to political instability.<sup>14</sup> The country's political and economic instability have constrained the mobilization of public and private domestic resources, thus limiting investment, entrepreneurship, and growth in productivity. Yet private investment and enterprise development are important drivers of employment creation, poverty reduction, long-term growth, and economic resilience through diversification and expansion of the growth base.<sup>15</sup>

Access to finance affects poverty through direct and indirect channels. The direct channel relates to income generated by job creation following new investments. The indirect channel is the wealth effect of economic growth resulting from an increase in investment. This study investigates the extent to which the bank's responsibility of monitoring contributes improving good corporate governance in the company with which the Bank has a credit agreement.

## **1.2 Statement of the Problem**

Burundi is among the poorest countries in the world.<sup>16</sup> It is evident that the lack of employment is highly observed. Good corporate governance, then, is essential to reduce that level of unemployment. The reason is that when a company is well governed it makes profits and by consequence will be able to provide employment and it will be involved in the corporate social responsibility which thing will improve the welfare of the society. There is therefore need to assess the way corporate governance is done in Burundi, if the corporate governance principles are well observed and to consider a possible option of developing a framework for corporate governance in Burundi.

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<sup>13</sup> Burundi Country Strategy Paper 2012-2016, Country Regional Department East A.(OCTOBER 2011) 1.

<sup>14</sup> Janvier D. Nkurunziza, Léonce Ndikumana, Prime Nyamoya; *The Financial Sector in Burundi; An Investigation of its Efficiency in Resource Mobilization and Allocation* (April 2011) 2.

<sup>15</sup> idem

<sup>16</sup> Fox News Network, LLC [US], The 10 Poorest Countries in the World (2015)

<https://www.foxbusiness.com/markets/the-10-poorest-countries-in-the-world> accessed 4 April 2018.

On the other side, the greatest risk that the banking sector is exposed on is the Credit risk. According to Janvier, "Banking soundness indicators are favorable, but the analysis of bank portfolios reveals a sharp rise in lending which may lead to vulnerabilities; since it occurred against the backdrop of weak economic performance".<sup>17</sup>

Most of the time, regulations are not clear about the fact for companies to produce financial statements. Then the question which may arise is "which technic is the bank going to use to ensure a good follow-up of the company's finances after, in case of the silence of law"? It's by the act of monitoring. In this research, we examine the corporate governance role of banks by investigating the effect of bank monitoring on the borrowers' earnings management behavior.

Additionally, the inadequacy of scholarly work on laws and policies under which banks should monitor and the infrequency of practical ways of how monitoring affects corporate governance performance in Burundi therefore prompted the need to critically examine the existing laws and policies guiding the credit agreements and corporate governance in Burundi. The way the act of monitoring can help securitizing the loan granted by influencing good corporate governance in the borrower company, however, when it's not well practiced, it can lead the borrower company to misbehave. Buy missing enough regulations stating how the act of monitoring should function, the party concerned may miss that opportunity of exercising an impact on the borrower companies, which thing can lead to not recovering the credit granted.

This brought the interest to the researcher to start a research on banks, which are the main source of financing in Burundi,<sup>18</sup> the credit agreement and the act of monitoring that banks exert on the borrower company to see how or if it can influence corporate governance in that company.

### **1.3 Research Questions**

This research seeks to answer the following questions:

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<sup>17</sup>The Financial Sector Assessment Burundi (December 2009) 4, accessed at [documents.worldbank.org](https://documents.worldbank.org) .

<sup>18</sup>Idem

(i)How corporate governance is conceived in Burundi and what are the elements determining good corporate governance?

(ii) What is the legal framework on which companies in Burundi and bank financing rely and the level on which they are practiced?

(iii) How does a good practice of the law of monitoring affect corporate governance in a company?

(iii) What is the relevance of the bank monitoring regulatory framework?

(iv) What recommendations can be relied upon to streamline a way forward

## **1.4 Research Objective**

Here the researcher is showing the general and specific objectives of the study.

### **1.4.1 General Objective**

The general objective of this study is to assess the role played by the law of bank financing, through monitoring and its influence in the corporate governance performance of the borrower company.

The researcher's concern is to analyze how Banks monitoring is practiced in Burundi, how Industry expertise facilitates monitoring and enables bankers to more precisely evaluate the on-going credit risk of individual borrower firms and if there is any regulation that clearly fixes the subject.

### **1.4.2 Specific Objectives**

The specific objectives of this study are:

(i) To analyze Laws and Rules regulating Companies and bank financing in Burundi and the Level of their applicability

(ii)To examine the place of bank monitoring in relation to the follow-up done to corporate governance in the borrower company

(iii) To assess the relevance of existing regulations on bank financing and its influence on corporate governance in Burundi

(iv) To provide recommendations on the way forward

### **1.5 Significance of the Study**

The research findings are to be used by various stakeholders in diverse ways. First of all, the management of companies by getting knowledge and information targeting to empower the company to have access to sustainable good corporate governance principles. Secondly, to the bankers and the borrowers: Here useful information is provided to help them understand the legal framework regarding the bank monitoring in Burundi and cases of malpractices arising from it. Thus, they learn to act lawfully in the application of the bank monitoring and act in compliance with those laws; the borrowers specifically get deeply entrenched understanding about the weaknesses in the practicability and applicability of bank monitoring. Therefore, they wish to engage the government of Burundi to cultivate a favorable investment climate in the country by harmonizing the application of the laws in the country.

The findings in this research are of help to the government of Burundi as regards improving the lending climate from commercial banks in this ways that the Government of Burundi may get to understand that investors both local and external face innumerable challenges from borrowing from commercial banks as regards to application and practice of bank monitoring in its corrective law framework. This may enable them to review the existing loopholes existing in the law such that the common man can be protected. Also, the study supported some form of ambition of extending a Burundian legal framework in commercial banks' lending for the benefit of Burundian.

The government is concerned with formulating policies that relate to the regulatory framework of credit agreement. As the sector grows, the government has to come up with policies that address the various challenges within the sector. Policy makers would benefit from the study findings as it would show the extent to which their regulations are practiced among the corporate governance principles and find ways of strengthening them. The study would also assist in promoting a good corporate governance framework in Burundi.

## **1.6 Scope of the Study**

This study examines the importance of bank financing, the obligation of monitoring which follows it and the influence it has on corporate governance performance in Burundi. It also does a critical analysis of the existing regulation on the granting of credit in Burundi and evaluates the issues and challenges of corporate governance in Burundi.

The limitations of our research are mainly the unavailability of sources. In fact, sources are not sufficient because the subject is not common, and then, sources are very few in particular books and case laws. Another limitation is the language. In fact, most of the documents available on the subject are in French and require by consequence a translation in English.

### **1.6.1 Content Scope**

This study first examined the place of corporate governance in Burundi, then assesses the regulatory framework of companies and bank financing in Burundi, assess the relevance of the bank monitoring regulatory framework to companies in Burundi and establish the relationship which exists between bank financing and good corporate governance.

### **1.6.2 Geographical Scope**

This study was carried out in Bujumbura City, in Burundi. This area was considered for this study because it has many commercial banks that deal with people and businesses. Some of the key institutions that will be targeted will include Central Bank of Burundi and some companies. These institutions are targeted for this study because they have rich information regarding bank monitoring practices and laws as well as policies regulating it, thus, it will be easier to investigate how the applicability of bank monitoring has affected their corporate governance.

### **1.6.3 Time Scope**

The study based on the information about corporate governance in Burundi and the legal intersection with bank's monitoring system using textbooks and documents

available since 2000 to 2016. This time frame will enable exploitation of different and detailed information regarding the assessment of the level of bank securitization of loans in the borrower company and how it affects its corporate governance in Burundi as well as some of its effects on the socio-economic development of the country.

## **1.7 Research Methodology**

This study employed mainly legal desk research design meaning that the study was based on the library materials involving both primary source and secondary source. Also, an empirical research has been conducted to assess the effectiveness of the importance of bank financing in improving corporate governance in companies. Thus, the research is socio-legal as it applied both doctrinal and empirical.

The primary sources used are domestic, regional and international laws and status. The secondary sources that the researcher used are the available literature on bank monitoring most especially in the areas of laws and policies as well as its impact on socio-economic development. This was derived from textbooks such as books, articles, working papers, reports and journals by visiting libraries and internet website.

The principal challenges are the fact that all the questions couldn't find answers because they were considered as confidential, internal to the Bank. Another is that things were not done in the time the researcher was expecting them to be done because of the unavailability of some people, and some of them asked for staying in confidentiality.

### **1.7.1 Population and Sampling**

For data collection on ground, in order to get the real context of banks financing companies by granting loans, respectively: the Head of Credit of CRDB Bank Burundi S.A, the Head of Credit of BANCOSU Bank Burundi, the Head of Credit of ECOBANK Bank Burundi, the Head of Credit of BCB Bank Burundi and a Credit Officer at KCB Bank Bujumbura, have been designated. The reason why the researcher chose them

in particular, is simply because those people are in the best position to answer these questions as they hold influential positions on the credit decision.

In an attempt to properly address the research objectives and questions, the study adopted the purposive sampling technique; hence the researcher used her knowledge of sampling to select particular individual and institutions. To obtain the data, the researcher has also prepared a questionnaire, which can be found at Annexure 1. The questionnaire has been answered by some directors of credit by way of interviews and documents sent by mail. Therefore, a total of 5 key respondents from whom the researcher got the information were selected; both from commercial banks institutions and both working in credit departments, were purposively chosen as subjects.

### **1.7.2 Data collection instruments**

Interview as a face –to-face conversation between an interviewer and a respondent conducted for the purpose of obtaining information, the interview guide was the main instrument used to collect data from the respondents about the mechanisms used by banks to monitor companies. The Interview protocols contained questions related to the research objectives.

### **1.7.3 Ethical considerations**

For ethical considerations, the researcher was ethical in collecting data and in the process of dissemination of findings, respect was shown to those who participated in the research and operate with sincerity and integrity. Therefore, to ensure confidentiality of the information provided by respondents and ascertain the practice of ethics in this study, the following activities were implemented by the researcher:

- An introduction letter was obtained from the University to solicit approval to conduct the study from the respective respondents
- Asked for authorisation through a written request or oral to respondents
- Acknowledge the authors quoted in this study through citations and referencing
- Present the findings in a generalized manner.

## 1.8 Literature Review

At this level, the researcher reviews the available literature in the field of study. It analyses previous studies in corporate governance, especially in relation to the impact that bank financing has in improving corporate governance in borrower companies, in order to identify the gaps that the study intends to fill.

There are different theories in the analysis of good governance in a company. The theory of the agency, for example, insinuates that the efficiency of the company depends essentially on its capacity to optimize the factors of production acquired on the market.<sup>19</sup> It follows that a successful system of government will be considered as an indifferent circumstance in improving the efficiency of companies.

For neo-classics, the company has a specific production function that allows it, from input factors, to obtain a certain amount of products (outputs). This production function has for a long time been considered external to the company, to its internal organization. It was believed that its performance depended only on the technical progress that optimizes the factors of production.

The internal organization of the company and its system of government were not considered part of the factors of production in the company's development strategy. However, today things have evolved, and what the researcher wants to bring out is that corporate governance is also important and can influence positively the performance of the company if it is well practiced. Moreover, the researcher tries to show in this study, the evolution of corporate governance and how it is conceived generally and how it is conceived in Burundi specifically.

A number of empirical studies on corporate governance internationally have found that there is a relationship between corporate governance and performance. They have mainly focused on its theories, models, principles, and best practice; and the relationship between corporate governance and performance.

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<sup>19</sup> Eric Le Boucher, *La Bonne Gouvernance d'Entreprise*, (trans: Good Corporate Governance) 3, accessed at [www.slate.fr/source/eric-le-boucher](http://www.slate.fr/source/eric-le-boucher).

The conclusion drawn from the studies on an international level is that there has been no common approach to corporate governance internationally.<sup>20</sup>

This brought the researcher to analyze corporate governance in the different ways in which it is defined and then try to find the similarities to see which one can be applied to Burundi.

Different studies have been done on corporate governance and the monitoring role played by banks in different countries. One of them is the study done by Justine Tumuheki who defined corporate governance in Uganda as “the formal system of accountability by senior management to the shareholders. A more expansive definition includes the entire set of legal rules, relations, and behaviors that constitute the system by which a company is controlled and directed”.<sup>21</sup> Tumuheki is among those who have adopted aspects of corporate governance in their laws, especially those relating to financial institutions and capital markets.<sup>22</sup>

Corporate law scholars have long assumed that corporate law does and should take the labouring oar for improving firm value and shareholder returns. Moreover, two decades of empirical research confirms that good governance adds value for shareholders.<sup>23</sup>

Legal and finance scholars have attempted to measure the value of corporate law and various corporate governance features, generally relying on stock market-based metrics., Daines and Subramanian have each attempted to measure the effect of Delaware corporate law on firm value.<sup>24</sup> Others have investigated the effects of specific corporate governance arrangements on stock prices and firm performance.<sup>25</sup>

As well, Mr Jimmy walabyeki did a study on the opportunities and challenges of corporate governance in Rwanda. According to Mr Jimmy, “The development of

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<sup>20</sup> Ernest Katwesigye, *Corporate Governance practices of selected faith based organizations in Uganda*, [Mbarara University of Science and Technology], (July 2015) 29.

<sup>21</sup> Justine TUMUHEKI, “An Analysis Good Corporate Reforms In Uganda, school for advanced legal studies - faculty of Law, University of Cape Town, (September 2007) 4.

<sup>22</sup> Ernest Katwesigye, *ibid.* 34.

<sup>23</sup> JOANNA M. SHEPHERD, FREDERICK TUNG AND ALBERT H. YOON, ‘*What Else Matters for Corporate Governance?: The Case of Bank Monitoring*’, (2008) 993.

<sup>24</sup> Robert Daines, ‘*Does Delaware Law Improve Firm Value?*’ J. FIN. ECON. 525, 556 (2001) 62.

<sup>25</sup> Barry D. Baysinger & Henry N. Butler, *Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition*, [1 J.L. ECON. & ORG.] 101, 121.

corporate governance in Rwanda has been greatly influenced by internal players in Rwanda, both public and private, as well as her development partners including other countries, and international bodies. Indeed, for the trends to continue, the same concerted effort will have to continue to take the corporate governance standards to the next level.”<sup>26</sup>

Rwanda is a country neighbouring Burundi. They have almost the same history and have gone through similar crises. These two countries can, by way of consequence, learn one from another, and produce a better result.

In Burundi, Alain has put an accent on the conceptual framework of corporate governance for Burundi saying that: “Essentially, governance addresses the leadership role in the institutional framework. Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation’s total portfolio of assets and resources with the objective of increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission”.<sup>27</sup>

About the Corporate Governance challenges in Burundi, Niyubahwe in his article on the conceptual framework of corporate governance in Burundi wonders what makes Burundi as well as African situation difficult. He pursues saying that it’s the fact that African economies are very much less developed economies. He adds on that, that some of the peculiarities include: the existence of a large number of state-owned enterprises, the culture of corruption or the pursuit of easy wealth, the weak nature of businesses environment, and low financial intermediation, among others.<sup>28</sup>

In his book, Niyubahwe tried to show the challenges that corporate governance is facing in Burundi and elsewhere in Africa, however, he didn’t go deeper to explore what corporate governance means and how it is represented in Burundi. He hasn’t also talked about the role played by bank financing and that is what the researcher is highlighting in this study.

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<sup>26</sup> Jimmy Walabyeki, ‘Corporate Governance in Rwanda: Opportunities and Challenges’, (April 17, 2017) 15.

<sup>27</sup> Alain Niyubahwe, Corporate governance: A conceptual framework for Burundi, [IDEC, 2009] 3, also available at [www.idec.org.bi/](http://www.idec.org.bi/).

<sup>28</sup> Ibid.

Douglas and Robert wrote on the importance of good governance over the company value. In fact, good governance improves company value, thereby benefiting public company shareholders.<sup>29</sup> There are many parties controlling the managerial agency costs, corporate law is not the only one concerned. Contracting parties of the firm may, therefore, be expected to contract for agency cost constraints and to monitor management. A well-developed finance literature shows banks to be especially adept at this monitoring function.<sup>30</sup>

This research is focused on the bank monitoring mechanism which is the system linking banks and the borrower company.<sup>31</sup> That is why the second part of this literature mostly discusses bank financing power to improve corporate governance in borrower companies. For better results, the standard credit agreement imposes numerous specific restrictions and obligations on the borrower company regarding operational matters and financial condition.<sup>32</sup> In addition, the bank also demands a regular flow of information from the borrower concerning its financial and operating performance. Randall and Philip<sup>33</sup> in their book highlight the fact that Banks enjoy far better information about a firm than individual or even institutional investors. They also give more details on how the borrower has to behave toward the bank and what are his obligations. Again, besides these regular reports, the borrower obligates itself to provide notice to the bank of the occurrence of any of a number of unfortunate incidents that might adversely affect the borrower's creditworthiness – material litigation, a default or potential default on the loan, or receipt of a government notice of a material regulatory violation, for example.<sup>34</sup>

About corporate governance through Corporate Law, Joanna and Frederick<sup>35</sup> attempted to measure effects of bank debt on firm value or to investigate the

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<sup>29</sup> Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, U.P.A.L. REV. 1209, 1242 (2006) 154.

<sup>30</sup> Paul A. Gompers, Joy L. Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, [118 Q.J. ECON.] (2003) 107, 144 (finding a relationship between an index of corporate governance measures and stock performance during the 1990s).

<sup>31</sup> Staples Inc., Current Report (Form 8-K), at 2 (Dec. 20, 2004) (describing 2004 Revolving Credit Agreement with Bank of America).

<sup>32</sup> *Idem*.

<sup>33</sup> Randall S. Kroszner & Philip E. Strahan, *Bankers on Boards: Monitoring, Conflicts of Interest, and Lender Liability*, [J. FIN. ECON. 415, 416] (2001) 62.

<sup>34</sup> *Ibid*.

<sup>35</sup> JOANNA M. SHEPHERD, *ibid*.

interaction of on-going bank monitoring with traditional corporate governance arrangements. If the company performs well after the bank loan announcement, it will be obvious that the system of monitoring is of a great importance in the borrower company concerning the improvement of corporate governance in it. Thus, bank monitoring will be either complementing or substituting certain corporate governance features.<sup>36</sup>

Theories have been developed in which it is suggested that banks may play an important governance role when companies are facing important challenges. These new theories focus primarily on the distress context and banks' influence once the firm has defaulted on its debt obligation. Thus, it is contended that bank monitoring has a broader influence, affecting firm performance generally because the theory focusing on the distress context implies that banks have the role of rescue. Kim first introduces the handful of studies suggesting the possibility of bank governance. She then briefly surveys the finance literature on bank monitoring.<sup>37</sup>

Banks are, generally, the central monitor of borrowers. George Triantis and Ron Daniels were among the first to suggest that bank monitoring might benefit a firm's claimants generally and a firm's shareholders in particular.<sup>38</sup> The interactive theory of corporate governance that they propose is the following: "stakeholders have the ability to discipline management by providing valuable information to one another."<sup>39</sup> The bank is the central monitor under this theory: its specialized monitoring abilities make it the low-cost monitor.<sup>40</sup> Because the borrower and creditors as a group care about minimizing total monitoring costs, the borrower willingly grants covenant protections to the bank that it may not grant other creditors.

The bank's contract rights and on-going monitoring enable it both to deter managerial slack and to detect it early. Upon detection, the bank may either exit or intervene, even to the point of having management replaced.<sup>41</sup> In either case, the

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<sup>36</sup> Idem

<sup>37</sup> Kim, *Does Corporate Governance Predict Firms' Market Values?: Evidence from Korea*, [22 J.L. ECON. & ORG. 2006].366, 368.

<sup>38</sup> D. Triantis, Ronald J. Daniels, *the role of debt in interactive corporate governance*, 1995 (by Winifred).

<sup>39</sup> Bert VC, *bank monitoring with monitoring by shareholders – the firm's traditional "owners."*

<sup>40</sup> Ibid.

<sup>41</sup> idem

bank's action signals other stakeholders, who may also act to protect their interests. While classic finance theory focuses on the conflicts between debt holders and equity holders<sup>42</sup>, especially as the firm nears distress, the bank lender may have good reason to work toward the firm's recovery as a going concern. The prospect of repeat business with the firm may serve to align the bank's interests with those of equity holders as to investment policy and the firm's recovery.<sup>43</sup>

Baird and Rasmussen have recently renewed the focus on creditor monitoring and corporate governance, describing creditor control as the "missing lever" in the corporate governance literature.<sup>44</sup> This means that there is something missing. The control of credit is not enough or doesn't exist at all in some places. The detailed reporting obligations and contract constraints imposed by the loan agreement, as well as the bank's ability to control the borrower's cash, enable the bank literally to control the firm.<sup>45</sup> Once the firm defaults, the bank's ability to discipline management is much greater than with traditional governance mechanisms.<sup>46</sup>

Tarinyeba, in her study on "Corporate governance in Uganda: the role of bank finance" is the one who tried to go in the same line with the researcher. She defines what corporate governance is, what are the mechanism used by banks to control companies and according to her, the essence of corporate governance is the following; " the law governing companies in Uganda is primarily with core company law matters, such as the formation of companies, the characterisation of companies- private/public, shareholder rights and duties of directors- corporate finance introduces a much broader perspective- when companies seek external finance, mechanisms must be provided to ensure that the interests of the providers of external finance are not only protected but balanced vis-à-vis the interest of the various parties in a corporation".<sup>47</sup>

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<sup>42</sup>Sadi Ozelge, *The Role of Banks and Private Lenders in Forced CEO Turnovers 1* (Jan. 15, 2008).

<sup>43</sup>idem

<sup>44</sup> Douglas G. Baird, Robert K. Rasmussen, 'Private Debt and the Missing Lever of Corporate Governance' UNIVERSITY OF PENNSYLVANIA LAW REVIEW [Vol. 154: 1209] (2006).

<sup>45</sup> idem

<sup>46</sup>idem

<sup>47</sup>Winifred Mary Tarinyeba, *Corporate governance in Uganda: the role of bank finance*, (may 2006) 67.

The researcher tries to bring something new on how corporate governance is presented in Burundi; she focuses on the role played by bank finance and the impact produced. The researcher also tries to find out what is necessary to adopt good corporate governance in all the departments.

## **1.9 Clarification of Key Terms**

**Corporate governance:** Corporate governance refers to a set of practices, duties, rules, and laws by which a corporation is directed, administered or controlled. It is a common term which describes the ways in which rights and responsibilities are shared between the various corporate participants, especially the management and the shareholders. It is based upon the principles of responsibility, transparency and accountability. An important object of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problems. It is a tool for socio-economic development. It is also known as corporation governance.<sup>48</sup>

**Bank financing:** a bank is an institution offering certain financial services, such as the protection of money, adaptation of domestic into and from foreign currencies, lending of money at interest, and acceptance of bills of exchange. Bank financing refers then to those finances provided by banks.<sup>49</sup>

**Company:** it is defined by the black law dictionary as a corporation, or less commonly, an association, partnership, union that carries on a commercial or industrial enterprise. Corporation, partnership, association, joint stock company incorporated or not and (in an official capacity) any receiver, trustee in bankruptcy, or similar official or liquidating agent, for any of the foregoing.<sup>50</sup>

**Monitoring:** Monitoring is an intermittent (regular or irregular) series of observations in time, carried out to show the extent of compliance with a formulated standard or degree of deviation from an expected norm. Monitoring, in the sense used here, is distinct from surveillance, which is repeated survey using a standard methodology

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<sup>48</sup> Corporate Governance Law and Legal Definition, available on <https://definitions.uslegal.com/c/corporate-governance/>, accessed on 6<sup>th</sup> may 2018.

<sup>49</sup> bank financing definition | English definition dictionary, available on <https://dictionary.reverso.net/english-definition/bank+financing>, accessed on 6<sup>th</sup> may 2018.

<sup>50</sup> Garner, BA. (ed) Black's Law Dictionary 9th edn (Dallas: A Thompson Reuters Business, 2009) p. 318.

undertaken to provide a series of observations over time. Surveillance can yield valuable information on trends in the state of biodiversity and Earth science, but does not by itself establish whether objectives or standards have been met. Information derived from surveillance may be used to inform judgements on the condition of features on sites.<sup>51</sup>

## **1.9 Organisational Layout**

This study consists of five chapters. Chapter one consists of an introduction, a background of the study, statement of the problem, objectives of the study, research questions, scope of the study, the significance of the study, methodology, literature review, and research structure

Chapter two is on the Generalities on corporate governance and bank financing; it discusses the general theory of corporate governance including the definition of corporate governance and its second part is on the general theory of bank financing, its place in economic development, the concept and the role of bank monitoring. This chapter also briefly discusses the key aspects of corporate governance

Chapter three describes corporate governance and bank financing in Burundi. This chapter provides background information about companies and corporate governance in Burundi including corporate governance issues, weaknesses in company law and enforcement mechanisms, the board composition, and structure. The chapter also analyses the banking system in Burundi, the Bank's policy regarding lending to companies and the role of codes and other statutes.

Chapter four provides an empirical analysis of bank finance and corporate governance in Burundi. This includes an attempt to establish to what extent corporations in Burundi rely on bank finance, monitoring tools employed by banks and how they impact on corporate governance.

Chapter five which is the last chapter of the study summarises the key research findings, draw conclusions and forward recommendations.

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<sup>51</sup> Joint Nature Conservation Committee (JNCC), available on <http://jncc.defra.gov.uk/page-2268>, accessed on 6<sup>th</sup> May 2018.

## CHAPTER TWO

### CORPORATE GOVERNANCE AND BANK FINANCING

#### 2.1 Corporate governance: Background

The World Bank, in 1989, identified the crisis of the African continent as a crisis of "governance" characterized by, according to HYDEN, defects judged as factors of the bad policy: "the personalization of power; Frequent violations of human rights; The inability of the central authorities to delegate power; The tendency of individuals to distance themselves from politics "<sup>52</sup> Faced with this economic and political crisis of the African continent, Sindzingre explained that the development of Africa would emerge from the improvement of the regimes of government.<sup>53</sup>

Ultimately, it is in this context where political adjustment is associated with economic adjustment that there has emerged the paradigm of good governance very peculiar to post-colonial Africa in order to "correct distortions of its economy and, consequently, create a climate favourable to the revival of its growth ".<sup>54</sup>

As we saw it in this background, it all started with a need to reorganize the economic and political sector. The mechanisms used to accomplish that project have evolved as time went on and it finally gave birth to the specific thing which is "corporate governance".

Corporate governance arrangements specify the rights and responsibilities of each participant in the corporation. It also specifies the rules and procedures which need to be followed while making decisions in the corporate business. We find through this structure, the objectives of the company and the means provided for attaining those objectives and for monitoring performance.<sup>55</sup>

The researcher finds that as governance is the leader while establishing the institutional framework, corporate governance clothes the responsibility of managing the company with all it implies as Alain says, "Essentially, governance addresses the

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<sup>52</sup>GORAN HYDEN, 'African Politics in Comparative Perspective' Cambridge University Press (New York, 2006) 72.

<sup>53</sup>Alice Sindzingre, 'CONTRASTING DEVELOPMENT TRAJECTORIES' CNRS (Paris, 1995) 440.

<sup>54</sup>Siméon Barumwete, [Bonne Gouvernance et Développement au Burundi : Realites et Perspectives] 'Good Governance and Development in Burundi: Realities and Perspectives', (05/03/2014).

<sup>55</sup>OECD Principles of Corporate Governance [20, rue des Grands-Augustins, 75006 Paris, France, 1999].

leadership role in the institutional framework. Corporate Governance, therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of increasing shareholder value and satisfaction of other stakeholders in the context of its corporate mission."<sup>56</sup>

Both academicians and practitioners have speculated that improvements in corporate governance structures would enhance the internal control mechanisms.<sup>57</sup>

### **2.1.1 Definition of corporate governance**

There is no single definition of corporate governance. The Cadbury code defines corporate governance as the system by which companies are directed and controlled.<sup>58</sup>

Stilpon has cited in his article<sup>59</sup>, the concept of corporate governance from the perspective of the OECD Principles. "The concept is two-fold: Corporate governance first encompasses the relationships and ensuing patterns of behaviour between different agents in a limited liability corporation; the way managers and shareholders but also employees, creditors, key customers, and communities interact with each other to form the strategy of the company. This is, one might say, the "behavioural side" of corporate governance. But corporate governance also refers to the set of rules that frame these relationships and private behaviours, thus shaping corporate strategy formation. These can be the company law, securities regulation, listing requirements'. But they may also be private, self-regulation. This is what they call the "normative side" of corporate governance."<sup>60</sup>

The definition provided by Justine is that; "corporate governance" is the formal system of accountability by senior management to the shareholders. A more

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<sup>56</sup> Alain Niyubahwe, op.cit 3

<sup>57</sup>Huson, Parrino and Starcks, 'Internal Monitoring Mechanisms and CEO Turnover: A Long - Term Perspective', the journal of Finance.(17 December 2002).

<sup>58</sup>Cadbury code section 2.5

<sup>59</sup>Stilpon Nestor, *International Efforts to Improve Corporate Governance: Why and How*, (OECD 2001) 1

<sup>60</sup>idem

expansive definition includes the entire set of legal rules, relations, and behaviours that constitute the system by which a company is controlled and directed.<sup>61</sup>

King IV widely defines corporate governance as “the exercise of ethical and effective leadership by the governing body towards the achievement of the following governance outcomes: ethical culture, good performance, effective control, legitimacy.” The King code highlights the word “corporate” in the term “corporate governance”. That word is meant to differentiate it from other forms of governance. The example given is that there is national governance or political governance. The King code goes on defining “corporate” as referring to organisations that are incorporated to form legal entities separate from their founders and therefore applies to all forms of incorporation whether as a company, voluntary association, retirement fund, trust, legislated entity or others.”<sup>62</sup>

If we try to put together all the different definitions provided for “corporate governance” we find that it refers to the rules by which companies are governed in order to protect the interests of investors and other stakeholders, including workers, customers, suppliers, local communities and environmental users. The researcher will need, then, to assess some of the most important aspects of corporate governance, which are the disclosure of audited accounts, director liability, adequate oversight by the board of directors, avoidance of anti-competitive behaviour and compliance with legal and regulatory requirements.

A disclosure is additional information attached to an entity's financial statements, usually as explanation for activities which have significantly influenced the entity's financial results.<sup>63</sup> Disclosure is very important and constitutes one of the aspects of corporate governance; however, mere non-disclosure of facts is not sufficient to support an action for compensation or damages, unless the non-disclosure is such as to make the statement in the prospectus false.<sup>64</sup>

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<sup>61</sup>Justine Tumuheki, *Good Corporate Governance: An Analysis of Corporate Governance Reforms in Uganda*, school for advanced legal studies - faculty of Law, University of Cape Town, (September 2007) 4.

<sup>62</sup>King IV, Report on corporate governance for South Africa (2016), 11.

<sup>63</sup>Disclosure — Accounting Tools, <https://www.accountingtools.com/articles/2017/5/6/disclosure>, (6 May 2017).

<sup>64</sup>Aaron's Reef v. Twiss (1896), A.C. 273, 287.

About adequate oversight by the board of directors, we find that while managing a non-profit's day-to-day finances is the job of an organization's senior management, the organization's board of directors has ultimate responsibility for overseeing the organization's financial affairs. This important board duty—the duty of financial oversight—encompasses an array of responsibilities, from establishing the CEO's compensation to approving the annual budget, to assess whether the organization should diversify its income stream.<sup>65</sup> Broadly speaking, a board of directors' financial oversight duties include: the establishing and ensuring the organization's compliance with proper financial systems and controls; the regularly evaluating the organization's financial health; and ensuring that the organization is on a financially sustainable path.<sup>66</sup>

To add on this, the control by the directors of the administration, business and policy of the company is normally done through a decision taken at what is called "board meetings". These consist of meetings of the directors constituted in the manner required by the articles. The directors must act collectively as a board, unless they have power, under the articles, to delegate any of their powers to a committee of the board or to a managing director or directors.<sup>67</sup>

### **2.1.2 Importance of corporate governance**

OECD Principles describe corporate governance in terms of relationship between management of company, its shareholders, its board and other stakeholders. It is a system which is used for the purpose of controlling and directing the companies. Here we find the importance of corporate governance in the way that without corporate governance there wouldn't be any leading line. Companies perform well because of corporate governance.

Corporate governance has the role of providing policies, governing the company, instituting customs, policies and laws to its employees. It has the role of preventing massive disasters by increasing the accountability of a company; Failed energy giant

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<sup>65</sup>The Role of the Board of Directors in Financial Oversight, A Guide for Board Members, P4.

<sup>66</sup>Idem

<sup>67</sup>H.A.R.J. WILSON, F.C.A., F.S.A.A. and T.W.SOUTH, B.A. Company Law, [10<sup>th</sup> ed. 1955] 157.

Enron, and its bankrupt employees and shareholders, is a prime argument for the importance of solid corporate governance.<sup>68</sup>

Corporate governance concerns a company's system of management and control. Specifically, it covers: proper management including the relationships between: board members; the board and the company's shareholders; and the company and other stakeholders such as employees, creditors and customers; and internal controls and processes. A good corporate governance framework will lead to internal discipline, accountability and transparency. Good corporate governance increases the long term value of a company and its potential for growth. It reduces risk, and strengthens reputation - key benefits which make corporate governance too important to be ignored by SMEs.

In brief, without corporate governance, a company should expect to face many problems because in a company there must also be a board meeting in which many problems are solved.

### **2.1.3 Important aspects of corporate governance**

The book of Bryan Coyle on Corporate governance demonstrates several concepts applying to sound Corporate Governance in all countries where international investors invest their money. Most of them are ethical.

Here the researcher understands that corporate governance can't be talked about without presenting the concepts. This means that to check good corporate governance in a company, we need to certify that all those aspects are respected. Everywhere we talk about good governance; these concepts must appear. The researcher considered one by one the seven concepts. The researcher first defines them and then after she tries to evaluate how they are observed in different companies.

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<sup>68</sup> Leo Sun in 'Why is Corporate Governance Important?' <http://www.businessdictionary.com/article/618/>.

### **a. Openness, Honesty and Transparency**

Those concepts are defined by Brian Coyle as willingness to provide information to individuals and groups about the company, without giving away commercially sensitive information, for openness.

Honesty is the fact of saying the truth and transparency refers to the case with which an outsider is able to make a meaningful analysis of a company and its actions. Transparency refers to both information about financial position of the company and to non-financial issues, such as the direction the company is taking, and so on.

### **b. Independence**

Independence refers to the extent to which procedures and structures are in place so as to minimise, or avoid completely, potential conflicts of interest that could arise, such as the domination of a company by an all-powerful chairman-cum-CEO, or a major shareholder.

### **c. Accountability**

It is defined as the quality or state of being accountable; especially: an obligation or willingness to accept responsibility or to account for one's actions.<sup>69</sup> It is also defined as the obligation of an individual or organisation to account for its activities, accept responsibility for them, and to disclose the results in a transparent way.<sup>70</sup>

Individuals who make decisions in a company and take actions on behalf of a company on specific issues should be accountable for the decision they make and the actions they take.

### **d. Responsibility**

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<sup>69</sup>Accountability | Definition of Accountability by Merriam-Webster, Available on <https://www.merriam-webster.com/dictionary/accountability>.

<sup>70</sup>What is accountability? definition and meaning - BusinessDictionary.com, Available on <https://www.businessdictionary.com/definition/accountability.html>.

Accountability goes hand in hand with responsibility. Any individual or group with authority and responsibilities should be held accountable for their achievements and performance.

#### **e. Fairness**

Fairness refers to the principle that all shareholders should receive equal consideration. Minority shareholders, for example, should be treated in the same way as majority shareholders.

#### **f. Reputation and reputation risk**

A company or business, like an individual, will be known widely by its reputation, defined as the character generally ascribed to that entity. A reputation may be good or bad and may be an asset or a hindrance.

It is generally recognised that well-governed companies should demonstrate these qualities because this will, first of all, improve the relationship between the company and its shareholders and other stakeholders, and uphold the reputation of the company with customers and the public in general; secondly, it is also evidence of good management and of a well-run company.<sup>71</sup>

The challenge in Burundi is to take cognisance of the peculiarities of the country and develop mechanisms and strategies to achieve this. Corporate governance needs to be improved. It is necessary to developing unique principles for corporate governance in Burundi, but this does not mean that a different standard of corporate governance applies to Burundi; it should be just a matter of time so that Burundi may reach the standards of other EAC countries.

#### **2.1.4 Analysis of the aspects of corporate governance**

These aspects of openness, honesty and transparency must be reflected in the financial statements that companies must provide to the creditor bank. Transparency can reinforce sound corporate governance and enable a bank's stakeholders and the general public to judge the effectiveness of its board and senior management.<sup>72</sup>

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<sup>71</sup>Brian Coyle, *Corporate Governance*, [6th Ed. ICSA information and Training Ltd],(2009) 27.

<sup>72</sup>Sarkis D. Yoghourtjian, *Corporate Governance in the Banking Sector: Issues & Challenges*, 24.

Independence is an important aspect as well. In fact, the company need to be free of its movement so that it may act in the right way without being tied up by anything else. This will help the decision maker of the company to be accountable and responsible of their actions.

The reputation of the company will also play an important role in relation to the creditor's position. All these elements constitute a press hold for the bank to insure that the company is worthy receiving the loan and that it will be able to pay back. This constitutes then the good corporate governance that creditors need to find in the borrower companies.

### **2.1.5 The continental aspect of corporate governance**

In many African countries, the application of corporate governance guidelines has been limited to capital markets as a means for attracting foreign investment and, therefore, has a limited reach.<sup>73</sup> Only few countries in Africa have stock exchanges. So, when corporate governance is framed in the context of a capital market, most of the 53 African countries are alienated. This is why, it is important to ensure that good corporate governance is implemented in all of Africa's companies (whether they are state-, foreign-, or locally owned).<sup>74</sup>

In Africa, more than elsewhere in the world, it is primarily state-owned enterprises that work in the natural resource and key strategic sector. These companies exert huge influence over their national economies, and therefore, it is essential that they adopt good corporate governance. Because state-owned enterprises have been put in the command position in the economy, good corporate governance and growth in this sector would lead to development in other sectors.<sup>75</sup>

The African countries need well-governed and managed business enterprises that can attract investments, create jobs and wealth and remain viable, sustainable and

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<sup>73</sup> Huson, Parrino and Starcks, op.cit., 4

<sup>74</sup> Ibid.

<sup>75</sup> Ibid.

competitive in the global market place. Good corporate governance, therefore, becomes a prerequisite for national economic development."<sup>76</sup>

Many African countries have already started to raise awareness on the importance of corporate governance and to implement guidelines. And according to Okeahalam and Akinboade (2003), the majority of failures in Africa and elsewhere have been attributed to an absence or dereliction of efficient corporate governance.

Burundi has yet to witness the meltdown experienced elsewhere, but should be able to learn some lessons and perhaps leapfrog some of these experiences. However this will only be possible if corporate governance is carefully analysed, and implemented in the context of appropriate institutions.

### **2.1.6 The OECD principles of corporate governance**

The Principles are useful to help policy makers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability. This is primarily achieved by providing shareholders, board members and executives as well as financial intermediaries and service providers with the right incentives to perform their roles within a framework of checks and balances.<sup>77</sup>

They need, by way of consequence to be concise, understandable and accessible to the international community and they might also be a useful tool to improve corporate governance in companies.

Let us see in details the way those principles are aligned in the OECD.

#### **a. Ensuring the basis for an effective corporate governance framework**

It is mostly about: The corporate governance framework which need to be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and well-functioning markets; The legal and regulatory requirements that affect corporate governance practices should be consistent with the rule of law,

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<sup>76</sup> Ibid.

<sup>77</sup> G20/OECD Principles of Corporate Governance, (September 2015) 9.

transparent and enforceable; The division of responsibilities among different authorities should be clearly articulated and designed to serve the public interest; Stock market regulation should support effective corporate governance; Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained; Cross-border co-operation should be enhanced, including through bilateral and multilateral arrangements for exchange of information.

## **b. The rights and equitable treatment of shareholders and key ownership functions**

First of all, basic shareholder rights should include the right to: "secure methods of ownership registration; convey or transfer shares; obtain relevant and material information on the corporation on a timely and regular basis; participate and vote in general shareholder meetings; elect and remove members of the board; and share in the profits of the corporation."<sup>78</sup>

Secondly, shareholders should be sufficiently informed about, and have the right to approve or participate in, decisions concerning fundamental corporate changes such as: amendments to the statutes, or articles of incorporation or similar governing documents of the company; the authorisation of additional shares; and extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

### **2.1.7 The level of its applicability**

The corporate governance level or performance "is most often used in law to mean carrying out a legal duty such as a duty under law or contract".<sup>79</sup> Dr Tebi Mbeli says that in the context of corporate governance, the concept is used as a measure of the level of organisational success. This involves the results of activities of a company over a given period of time, what has been described as operating earnings in excess of cost of capital.

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<sup>78</sup> Ibid. p10.

<sup>79</sup>Valentine Tebi Mbeli, *Legal Perspectives on Corporate Governance in Cameroon and Nigeria* (LAP LAMBERT Academic Publishing,2016),136.

To assess the level or the performance, The researcher, then, needs to analyse the external drivers of good corporate governance which are laws, rules and institutions that provide a competitive playing field and discipline the behaviour of insiders, whether managers or shareholders. Those elements cited, are indicators of whether there is good corporate governance or not.

“Experience in developed market economies indicates that the legal framework for competition policy, the legal framework for enforcing shareholders rights, systems for accounting and auditing, a well-regulated financial system, the bankruptcy system and the market for corporate control are among the tools that discipline corporations”.<sup>80</sup>

Analysing laws and rules helps to know the level of the applicability of corporate governance in Burundi. There is a hypothesis that the legal system is a fundamentally important corporate governance mechanism.<sup>81</sup> In particular, they argue that the extent to which a country’s laws protect investor rights and the extent to which those laws are enforced are the most basic determinants of the ways in which corporate finance and corporate governance evolve in that country.<sup>82</sup>

The essence of good corporate governance is ensuring trustworthy relations between the corporation and its stakeholders. Therefore, good governance involves a lot more than compliance. Good corporate governance is a culture and a climate of Consistency, Responsibility, Accountability, Fairness, Transparency, and Effectiveness that is deployed throughout the organisation (the ‘CRAFTED’ principles of governance).<sup>83</sup>

### **2.1.8 The corporate governance regulatory framework**

At the international level, the OECD principles of corporate governance set rules and guidelines to help us understand corporate governance and provide useful tools of how to put it in practice. On a continental level we have the King code which talks about corporate governance. It sets in its different parts topics on leadership, ethics

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<sup>80</sup>Denis and McConnell, 2004, [www.academicjournals.org/article/article1380721950](http://www.academicjournals.org/article/article1380721950).

<sup>81</sup>Rafael La porta, Florencio Lopez – de silanes, Andrei Shleifer and Robert Vishni, *Law and Finance*, 1998.

<sup>82</sup>Valentine Tebi Mbeli, op. cit., p 9.

<sup>83</sup>Yılmaz Argüden, *A Corporate Governance Model: Building responsible boards and sustainable businesses in the Private Sector Opinion*, [Issue 17 A Global Corporate Governance Forum Publication] 3.

and corporate citizenship; the strategy, performance and reporting; the governing structure and delegation; the governing functional areas and the stakeholder relationships.<sup>84</sup> The researcher could refer to it and find important information.

In Burundi, the Companies Act provides laws and rules establishing good corporate governance by providing meanings, memorandum and articles of association, it talks about accounts and audit. Good Corporate governance involves or implies that a Company is well governed and that it is well performing. This can be verified through the company's management behaviour and its financial reports.

## **2.2 Banking and Financial Services**

Starting by the background, the modern term 'bank' comes from the 'banco' or merchant's bench in the marketplaces of medieval Italy: money dealing was conducted from a portable bench, which would be publicly broken in the event of failure of the merchant's business – the origins of the concept of bankruptcy. But banking as an activity is much older. The key characteristics of banking are: taking money on deposit and lending.<sup>85</sup>

According to the Financial Institutions Act, "bank" means any company licensed to carry on financial institution business as its principal business, as specified in the Second Schedule to this Act and includes all branches and offices of that company in Uganda<sup>86</sup>

Capital markets and the market for corporate control have not played a significant governance role in some jurisdictions. Rather, banks have been instrumental in shaping the corporate governance system of Germany, Italy, most of continental Europe as well as emerging and developing countries. Germany is particularly singled out at the country where banks have for a long been a part of the corporate governance system.<sup>87</sup>

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<sup>84</sup>King IV, Report on corporate governance for South Africa 2016.

<sup>85</sup>Elisabeth Wentworth, Essential Banking Law and Practice, p3 , [www.fos.org.au/public/download/?id=2793](http://www.fos.org.au/public/download/?id=2793).

<sup>86</sup> Financial Institutions Act of Uganda, 2004, Section 3.

<sup>87</sup>Winifred Mary Talinyeba, op. cit, 59.

### **2.2.1 Commercial banks and microfinance**

In Burundi, banks are required to justify a minimum capital of BIF 2,500 million by 31 December 2007 and BIF 3,500 million by 31 December 2008 at the latest. Financial institutions are required to provide proof of a minimum capital of BIF 2,000 million by 31 December 2007 and BIF 3,800 million by 31 December 2008 at the latest.<sup>88</sup>

A commercial bank is a financial institution which performs the functions of accepting deposits from the general public and giving loans for investment with the aim of earning profit.<sup>89</sup> The two most distinctive features of a commercial bank are borrowing and lending, i.e., acceptance of deposits and lending of money to projects to earn Interest (profit). In short, banks borrow to lend. Commercial banks increase the supply of money by creating credit which is also treated as money creation. Commercial banks create credit in the form of secondary deposits. The rate of interest offered by the banks to depositors is called the borrowing rate while the rate at which banks lend out is called lending rate.<sup>90</sup>

In fact, commercial banks, as their name suggests, are profit-seeking institutions, i.e., they do banking business to earn profit.

Microfinance is the category of financial services offered to lower-income people, where the unit size of the transaction is usually small ("micro"), typically lower than the average GDP per capita, although the exact definition varies by country. Today, microfinance covers the full range of financial services—credit, savings, remittances, insurance, and leasing, among others—which are increasingly provided by a diverse set of financial service providers.

In recent years there has been a proliferation of microfinance institutions, the vast majority of which could not sustain their activities. Restoring the credibility of the microfinance sector is crucial in improving the supply of credit in rural areas.<sup>91</sup> Given

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<sup>88</sup>CIRCULAR N ° 01/06 relating to the minimum capital of banks and financial institutions issued pursuant to Decree-Law No. 1/017 of 23 October 2003 regulating banks and financial institutions, Art 1 and 2.

<sup>89</sup> Commercial Bank: Definition, Function, Credit Creation and Significances available at [www.economicdiscussion.net/banks/commercial-bank-definition-function.../607](http://www.economicdiscussion.net/banks/commercial-bank-definition-function.../607).

<sup>90</sup> Ibid.

<sup>91</sup> INVESTOR'S GUIDE TO BURUNDI, p 43.

its central role for growth and poverty reduction, the Central Bank of Burundi (BRB) is now closely supervising the financial activities of the microfinance institutions. It has also encouraged the creation of a Network of Microfinance Institutions (RIM) in order to definitively restore order in this sector. Overall, 26 microfinance institutions were licensed by the BRB at end of 2007. Their financing is based primarily on contributions from projects and from NGOs involved in the sector.<sup>92</sup>

However, even though microfinances are important, commercial banks are playing an increasingly important role in many financial services markets across the world. Compared with many existing providers of microfinance, commercial banks have potential competitive advantages in a number of areas, such as recognizable consumer brand names, existing infrastructure and systems, and access to capital.<sup>93</sup>

Banks have incentives to collect information and monitor firms to ensure the returns to the depositors.

### **2.2.2 The place of banks in developing economies**

"First, banks have an overwhelmingly dominant position in developing-economy financial systems, and are extremely important engines of economic growth<sup>94</sup>. Second, as financial markets are usually underdeveloped, banks in developing economies are typically the most important source of finance for the majority of firms. Third, as well as providing a generally accepted means of payment, banks in developing countries are usually the main depository for the economy's savings. Fourth, many developing economies have recently liberalised their banking systems through privatisation/disinvestments and reducing the role of economic regulation."<sup>95</sup>

Different Researches have found that banks are critically important for industrial expansion, the corporate governance of firms, and capital allocation. When banks efficiently mobilize and allocate funds, this lowers the cost of capital to firms, boosts capital formation, and stimulates productivity growth. Thus, the functioning of banks

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<sup>92</sup> idem

<sup>93</sup> Jennifer Isern. And David Porteous; *Commercial Banks and Microfinance: Evolving Models of Success*; (JUNE 2005) 1.

<sup>94</sup> Alain Niyubahwe, op.cit., p 12.

<sup>95</sup> Idem p 12,13 (*Banque de la Republique du Burundi Service Supervision des Etablissements Bancaires et Financiers et Stabilite Financiere*, available on <http://www.brb.bi>).

has ramifications for the operations of firms and the prosperity of nations. Given the importance of banks, the governance of banks themselves assumes a central role. If bank managers face sound governance mechanisms, they will be more likely to allocate capital efficiently and exert effective corporate governance over the firms they fund.<sup>96</sup>

The main point of the theory of Irena Grosfeld is that “introducing (or not breaking up) early in the process close links between banks and industry will hinder rather than facilitate enterprise restructuring. Bank dominated system does not create appropriate incentives for the generation of information about different investment opportunities.<sup>97</sup> How efficient banks' role in corporate governance is, obviously depends upon the degree of concentration of debt (the size of loans) and of equity claims (the voting rights). It also depends upon banks specific skills as monitors.<sup>98</sup>

According to Edwards and Fischer (1994) banks have an additional advantage over other financial intermediaries (such as pension funds or insurance companies) because they have direct access to important information: firms usually hold their accounts with the banks and thus the latter can directly observe all withdrawals and deposits which permits to assess the firm's financial situation.<sup>99</sup>

### **2.2.3 The Role of Bank Monitoring as Corporate Governance Mechanisms**

Bank monitoring is the system by which banks exert a certain control on the company. Basically, in some countries where the economic system is characterized by bank financing as an external source of financing, corporate governance mechanisms can also be done by the banks through direct ownership or financing mechanisms.<sup>100</sup> It is showed that agency problem is reduced in such situation. Some literatures in financial economics<sup>101</sup> explore how banks run their unique role and how

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<sup>96</sup> Alain Niyubahwe, op.cit., p 12.

<sup>97</sup> Irena Grosfeld, FINANCIAL SYSTEMS IN TRANSITION: *THE ROLE OF BANKS IN CORPORATE GOVERNANCE*, (Dec 18, 2017).

<sup>98</sup> Idem.

<sup>99</sup> Ibidem

<sup>100</sup> Alexandra Ryan Ahmad Dina\*, *The Effect of Bank Monitoring as an Alternative of Corporate Governance Mechanisms on the Borrowers' firm value: Evidence from Indonesian listed firms*, (2011) 74.

<sup>101</sup> Ahmed HIKMI, Miia PARNAUDEAU, '*Le rôle du financement bancaire dans le processus d'innovation*' available at [http://www.cairn.info/article.php?ID\\_ARTICLE=VSE\\_178\\_0091](http://www.cairn.info/article.php?ID_ARTICLE=VSE_178_0091) (2008).

relationships between the banks and the companies affect the company's business. However, there are still only few empirical evidences about the monitoring role of banks as one of corporate governance mechanism.<sup>102</sup>

We will develop much more widely, the concept of bank monitoring in chapter 4.

## **2.3 Conclusion**

In conclusion, it is obvious that the concept of corporate governance has been widely defined by different authors and in different ways but all the different points converge in one that defines corporate governance as a set of rules that help ruling or directing a given company.

The researcher has highlighted the different aspects of corporate governance that will help the reader to know how to evaluate the level on which corporate governance is practiced in companies. It is also important to talk about banks and microfinances which thing helps the ready to be in a good position of choosing the most advantageous institution.

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<sup>102</sup> Alexandra Ryan, Ahmad Dina, op. cit, 74

## CHAPTER THREE

### ANALYSING THE LEGAL FRAMEWORK OF COMPANIES AND BANKS IN BURUNDI

#### 3.0 Introduction

Many state-owned enterprises were created just after independence, but after a few years, they began closing doors one after the other. People who are not involved in the public life of the country are wondering why these companies do not last long enough and continue to ask so many questions about their viability but there are no obvious answers.<sup>103</sup>

Crises of governance have been observed in Africa, around the 1980s. The democratisation of institutions, and criteria for good governance such as transparency, the rule of law, responsibility and accountability became the conditions to obtain aid. However, the policy documents and the development planning such as Strategic Framework for Poverty Reduction, Burundi Vision 2025, National Strategy for Good Governance and Fight against Corruption, are now perceived as conditions for the development of Burundi and a social and political road to rooting these ethics.<sup>104</sup>

This chapter provides an overview of corporate governance in Burundi, including major corporate governance challenges, lack of a corporate Law, the role of codes and other statutes in promoting corporate governance.

The purpose of this chapter is also to analyse the legal rules assessing the place of corporate governance in the company code and the role played by banks through the bank's procedures and policies.

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<sup>103</sup>Salvator Nyandwi, *Analyse des déterminants de la faillite des entreprises publiques burundaises: cas du complexe textile de Bujumbura (COTEBU)*, (2013)1.

<sup>104</sup>Siméon Barumwete, 2014, op.cit., 1.

### **3.1 The legal framework**

It is helpful to analyse the legal framework of companies and of banks in Burundi, in order to understand better how corporate governance is aligned and where improvement is needed.

There is a need for a good institutional and legal framework for building and enabling a strong economic environment and to facilitating a country's efforts to promote companies growth. This chapter, therefore, reviews the legal reforms related to companies and lending in commercial banks in Burundi.

Procedures for incorporation of companies in Burundi have recently been significantly reduced and centralised. A new Company Act was enacted on May 30, 2011. In previous years, it was required to complete 32 steps or procedures up to 32 days and BIF 500,000 in order to create a business. Today, within a single day, and with only BIF 42,000, it is possible to create a business.<sup>105</sup>

This was possible through the establishment of a single window/a One Stop Center integrating the Burundi Investment Promotion Agency (API), the Commercial Court (Office of the Registrar General Unit) and Burundi Revenue Authority services. To register a local enterprise or a foreign subsidiary, API provides a quick and efficient registration service allowing having a business incorporated within 24 hours. This process involves simultaneously obtaining the certificate of incorporation (business registration) and a Tax Identification Number (tax registration). It is worth mentioning that a draft new Company Law is under consideration by the cabinet and is due to be passed shortly.<sup>106</sup>

### **3.2 Legal framework on companies in Burundi**

In this section, the researcher is going to analyse the Law No. 1-002 of 6 March 1996 on the Companies Act. The Act gives the foundational corporate governance framework providing for among others, incorporation of companies, types of companies, duties of directors, rights of shareholders, protection of minority

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<sup>105</sup>Investment Guide – Burundi, 10

<sup>106</sup> idem

shareholders, maintenance of capital, and reporting requirements such as filing annual returns and external audits. There is no corporate governance code in Burundi, the provision for duties of shareholders, requirements for approval of board members, internal audit requirements, the conduct of board meetings, board committees, responsibilities of management and a code of conduct, are found in the existing Companies Act.

### **3.2.1 Definition of a company**

The companies Code of Burundi provides in its articles 1-3 the definition of what a company is. The company is created by a contract bringing together two or more persons who agree to put together some of their goods or their industry, in order to share the profits or profit from the economy that can result from it. The partners also undertake to contribute to the losses.

By way of derogation from the preceding article, the company may be created by the will of one person, in accordance with the provisions of Title 3, Chapter 2, Section 5 and Chapter 3, Section 1, respectively.

The contract of a company is materialized by written statutes. It may be amended at a later date by the will of the shareholders and in a manner freely defined by them, in compliance with the law and the regulations.

### **3.2.2 Categories of companies**

In Article 162, the Law n ° 1/09 of 30 May 2011 on the code of private companies and public participation recognizes the following categories of companies:

First of all, there are private companies whose capital is wholly owned by private individuals and legal entities: there is the civil society; the partnership; the limited partnership; the private limited liability company; the unipersonal company; the cooperative society; the public limited company.

Secondly, companies with public participation by the State, municipalities and/or other legal persons governed by public law and by any foreign public body which are: the public company; the mixed society. They all have legal personality.

In addition to these categories of companies, article 123 also recognizes and regulates the following companies: the joint venture; the momentary society. They do not have legal personality.

### **3.2.3 Regulatory framework on the Board of directors**

Legally speaking, the essential way of evaluating the performance of a company is whether directors have lived up to their responsibilities to stakeholders and for appropriate sanctions to be imposed in default.<sup>107</sup>

A board of directors is commonly used to mean a group of individuals who are appointed by shareholders to oversee the activities of a company. It is almost a global imperative that every public company must have a board of directors.<sup>108</sup>

The law n ° 1/09 of 30<sup>th</sup>, May 2011 on the code of private companies and public participation stipulates in its articles how the board of directors is regulated.<sup>109</sup>

On the article 315, the Board of Directors ensures the management and the good functioning of the company. Members of the Board are elected by the General Assembly from among the members. The number and duration of their appointments are set by the Statutes. Retiring members may be reappointed.

The article 316 stipulates that without limitations other than those of powers expressly reserved to the General Meeting, the Board of Directors has the most extensive powers of administration and management. It directs and supervises the activities of the Corporation, keeps accurate accounts and monitors the management. It must also present to the Annual General Meeting a report on the activities of the past fiscal year as well as the accounts duly audited by the Supervisory Board and make any proposals to improve the services provided to the members and possibly on the Distribution of rebates.

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<sup>107</sup>Odozi, v. *"promoting effective corporate governance in Nigeria"*, (by Valentine Tebi Mbeli in Legal Perspectives on corporate governance in cameroon and Nigeria).

<sup>108</sup> Valentine Tebi Mbeli, op. cit., p. 65.

<sup>109</sup>Law n ° 1/09 of 30 May 2011 on the code of private companies and public participation, [1363 BOB N ° 5/2011] (the law is in French and have been translated. Source of translation: Google translate with the researcher's own confirmation).

On the article 317 we find that, in relations between shareholders, and except the contrary provision of the Statutes, the board of directors commits the Corporation to the acts of management and administration in the interests of the company. In dealing with third parties, the Board of Directors is vested with the broadest powers to act in all circumstances on behalf of the Company, subject to the powers expressly granted to the Shareholders by law. The corporation is bound, even by the acts of the Board of Directors which do not fall within the scope of the company's object, unless it proves that the third party knew that the act exceeded this purpose or that it could not meet the circumstances. The publication of the Statutes alone is not sufficient to constitute such proof. The statutory clauses limiting the powers of the Board of Directors resulting from this article do not affect the third parties.

The members of the Board of Directors are responsible. Article 318 stipulates that they are responsible either individually or jointly, to the Corporation and to third parties, either for breaches of the laws and regulations applicable to the company, for breaches of the Articles of Association or for misconduct in management.

On article 319, the point is that any member of the Board of Directors may be dismissed at any time during his term of office by decision of the General Meeting for gross negligence, negligence or incompetence.

The Chairman of the Board of Directors represents the Cooperative in Justice and vis-à-vis third parties. The conditions of appointment and dismissal, as well as the duration of the mandate and the remuneration of the President, are determined by the Statutes or by the decision of the Ordinary General Assembly.<sup>110</sup>

### **3.2.4 Characteristics of the company**

Again we find in the companies code, exactly on the article 6, the following provision: "- The articles of association of the company shall specify the form, purpose, corporate name, registered office, share capital, contributions of each shareholder, duration, and terms of operation, changes, dissolution and Liquidation of the company."

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<sup>110</sup>Law on the code of private companies and public participation, op.cit., Article 320.

### **3.2.5 Share capital**

The company must have a share capital, determined according to the will of the partners, taking into account, in particular, the nature of the activities of the company and the amount of the planned investments. Nevertheless, the law can set a minimum social capital for specific sectors of activity<sup>111</sup>

The share capital is the sum of the contributions of the partners in kind, or in cash. It is divided into securities of equal value, called nominal value. The nominal value of corporate securities is set by the articles of association.<sup>112</sup>

The share capital must be fully subscribed. The terms of his release are fixed for each type of company by this law.

The share capital may be increased or reduced by an extraordinary resolution of the shareholders, in accordance with the conditions laid down in the articles of association.<sup>113</sup>

### **3.2.6 Financial statements**

About the accounting documents, at the close of each financial year, the board of directors, the management board or the manager shall draw up an inventory of the various assets and liabilities existing at that date. They also provide a chart of the management balances, the changeover table to the balances of the property accounts, the balance sheet and the tax schedule. They shall draw up a written report on the situation of the company, and its activities during the past financial year and shall report on their terms of reference.<sup>114</sup>

The documents referred to in the preceding article are made available to the auditor (s) and the partners at the registered office, within a sufficient period before the meeting of the shareholders called to approve the accounts of the society. The

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<sup>111</sup>Law No. 1-002 of 6 March 1996 on the Company Code ,Article 14

<sup>112</sup> ibid , Art.15

<sup>113</sup> Ibid, Art.17

<sup>114</sup> Ibid, Art.40

deadline and the procedures for making such documents available shall be laid down in the statutes.<sup>115</sup>

Article 42 states that the meeting of the general assembly of approval of the accounts must take place at the latest five months after the end of the financial year.

On the article 43, we find that the table of the characteristic management balances, the changeover table to the balances of the property accounts, the balance sheet and the tax annex shall be drawn up for each financial year using the same forms and methods of valuation as for the years preceding. However, in the event of a proposed amendment, the shareholders' meeting shall decide on the proposed amendments, in the light of the accounts drawn up in accordance with both old and new forms and methods and on the report of the board of directors, the management board or the manager, as the case may be, and the External Auditor, if any.

Insofar as this section introduces rules different from those enacted by the tax law, extra-regular adjustments must be made for the tax presentation of the documents provided for in the preceding articles.<sup>116</sup>

### **3.2.7 Duties of the Statutory Auditors**

Article 100 of the Companies code of Burundi stipulates that in companies where there is an auditor, the auditor shall verify the regularity and fairness of the inventory and the accounting records set out in Chapter 1, Section 1 of this title.

In this article, we see that the law provides a person, the auditor, to verify the regularity and fairness of the inventory. Fairness is one of the corporate principles that need to be established in order to certify that there is good corporate governance.

The statutory auditors certify that the annual accounts are regular and sincere and give a true and fair view of the results of operations for the past financial year and

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<sup>115</sup> Ibid. Art. 41

<sup>116</sup> Ibid. Art 44

the financial position of the company's assets at the end of the financial year. They shall also have the permanent mission, with the exception of any interference with management, to verify the company's values and accounting documents and to verify the conformity of its accounts with the rules in force. They also verify the accuracy of the consistency with the annual accounts, the information given in the management report of the directors and the documents sent to the partners on the financial position and the financial statements. They ensure that equality has been respected among the partners.<sup>117</sup>

Article 103 states that at any time of the year, the auditors, together or separately, shall carry out all checks and controls as they deem appropriate. They may be notified on the spot of all documents they deem useful for the performance of their duties, including all contracts, books, accounting documents and minutes of meetings.

The statutory auditors may also collect all the information necessary for the performance of their duties vis-à-vis third parties who have carried out transactions on behalf of the company. However, this right of information may not extend to the disclosure of documents, contracts, and documents held by third parties, unless they are authorized by a court decision. Professional secrecy cannot be contrary to the statutory auditors, except by the auxiliaries of the courts.<sup>118</sup>

Article 105 states that the statutory auditors shall inform the directors of the checks and inspections carried out by them and the various surveys carried out by them; the items in the balance sheet and other accounting records to which amendments appear to be required, making any relevant observations on the valuation methods used in preparing such documents; Irregularities and inaccuracies that they discovered and the conclusions to be drawn from the observations and rectifications above on the results of the financial year compared with those of the previous financial year.

The auditors request explanations from the managers who are required to reply to any fact likely to compromise the continuity of the exploitation which he has

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<sup>117</sup>articles 101 and 102, Companies code, op.cit.

<sup>118</sup>Idem Article 104

observed during the exercise of his mission. In the absence of any reform or if it is not satisfied, the auditor invites the directors to deliberate on the facts found. If the auditor considers that the continuity of the operation remains understood, the auditor prepares a special report which is presented at the next general meeting or in case of urgency, to a general meeting of shareholders which he convenes himself to submit its conclusions. The statutory auditors are then summoned to the meeting of the executive organs, which approves the accounts for the past financial year, as well as all meetings of shareholders.<sup>119</sup>

### **3.2.8 Public companies**

We can find the definition of a public company on the articles 358 and 359 of the company's code. It is when the State, the municipality or other legal persons established under public law create alone or in association, an enterprise whose object is industrial, commercial, financial and agricultural activities, they take the form of a Public company or a joint venture.

A public corporation is a legal person created exclusively by the State, the municipality, one or more legal persons of public law, alone or in association. It has its own heritage, financial and organic autonomy.

#### **a. Capital formation**

The public company with participation of the municipality is created by decision of the communal council which indicates its denomination, its date of creation, its head office, its mission, the supervisory authority. It is also created by decision of the municipal council which indicates its denomination, its date of creation, its head office, its mission, the supervisory authority, if any and the other elements of the articles of association of the company.

The public company may be created by decree or decision of the municipal executive when it meets only legal entities of public right, dismemberments of the State or the municipality. In this case, the creation decision indicates the name, the date of

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<sup>119</sup> articles 106 and 107 , Companies code, OP. CIT.

creation, the registered office, the mission of the company, the supervisory authority.<sup>120</sup>

The body entrusted with the execution of the creation decision sets the other elements of the constitution in the statutes.

The share capital, fully subscribed, must be released from at least one third of the constitution; it must be fully paid up within two years from the date of creation of the company.<sup>121</sup>

Contributions in kind shall be assessed in accordance with the provisions of Title 1, Chapter 4 of that Law. Each associate member is only liable for social debts to the extent of its contribution.

This is where the word "limited liabilities" finds all its meaning, being only liable to the extent of its contribution.

## **b. Administration - Management**

When the public company has two or more partners, it is provided with a general meeting.

The general meeting of shareholders shall adopt the necessary measures for the life of the company; approve the management of the board of directors and the report of the statutory auditor. The articles of association determine the terms and conditions for the convening and holding of general meetings. Each shareholder has as many votes as subscribed shares. The rules of quorum and majority required for the validity of decisions are those laid down for public limited companies.

The ordinary general meeting shall meet at least once a year, at the latest five months after the closure of the accounts, to approve the report with the amendment of the statutes.

The public company is managed by a board of directors appointed by the partners. It shall include representatives of the associates and, where appropriate, one or two

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<sup>120</sup>Ibid. Articles 363-365

<sup>121</sup>Ibid. Article 368

persons appointed for their particular competence and experience, representatives of users and employees. Their number is set by the statutes.

The board of directors has a general power of administration of the company, and defines, within the limits of the corporate purpose, the orientations of the activity of the company. Where the public company does not have a general meeting, the board of directors approves the accounts and gives discharge to the general manager.

Any agreement with the company to which one of the members of the board of directors or the general manager has an interest, even indirect, must be authorized in advance by the board of directors.

The absence of this authorization is not binding on bona fide third parties. When the company has a general meeting, it must be approved by the next meeting of the meeting.

The members of the board of directors shall serve for a term fixed by the statutes. The General Manager ensures the smooth running of the company within the framework of the guidelines set by the Board of Directors. It is responsible to the Board of Directors for its management.<sup>122</sup> The general manager also represents the company in respect of third parties.

### **3.2.9 Statutory auditor and independent auditor**

The annual accounts and the management report must be audited by one or more statutory auditors appointed by the general meeting or by the board of directors when there is no general meeting. The Minister having the finances in his or her attributions may also appoint one.

At the end of the financial year, the accounts of the company shall be audited and certified, after adjustment of the records if necessary, by an independent auditor appointed by the general meeting or, there is no general meeting, by the board of directors by means of a public call for candidates to compete.<sup>123</sup>

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<sup>122</sup>Companies act, op.cit., Articles 372-384

<sup>123</sup>Ibid., Articles 387 and 388,

### **3.3 Legal framework on bank financing in Burundi**

In this section the researcher is going to analyse the banking system in Burundi through the Law n ° 1/017 of 23 October 2003 on the regulation of banks and financial institutions.

#### **3.3.1 The Banking System in Burundi**

Burundi's formal banking sector is small in size and remains at an early stage of development. Formal financial services mainly cater for Burundi's small elite of wealthy business people and government officials. The majority of Burundians are unbanked, relying on microcredit and informal lending. Commercial banking is dominated by the state and facilities are located primarily in urban areas. The central bank is the Bank of the Republic of Burundi (Banque de la République du Burundi, (BRB). While there are no restrictions on foreign investors' access to local credit, the resources in the local market are limited and long-term capital is largely unavailable. However, there have been several initiatives to improve the banking sector, including opening the economy to foreign banks. The country has experienced an increase in new products and technology within the financial sector, including telephone and internet banking.<sup>124</sup>

There are currently eight main commercial banks in Burundi, of which three have private capital; this can be illustrated in this way: Innovative SMEs, especially smaller ones, when they cannot access conventional bank financing, resort to private channels such as venture capital. This mode of financing remains marginal and it mainly support start-ups in their creation phase when their project is innovative and with high growth potential.<sup>125</sup> The three most important ones are the Commercial Bank of Burundi, Interbank and the Credit Bank of Bujumbura, all of which are foreign owned, mostly by Belgian banks. The banking sector is poorly developed, it suffers from excessive bureaucracy, offers limited services to consumers and has old technology compared to the sub-region.<sup>126</sup>

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<sup>124</sup>Investment Guide – Burundi p 11

<sup>125</sup>by Ahmed HIKMI and Mia PARNAUDEAU in *The role of bank financing in the innovation process: the case of four European countries*, 2008, p 26 (a French translation)

<sup>126</sup> INVESTOR'S GUIDE TO BURUNDI, p 43

The law enforcing obligations in BCB is the Banking law, BRB regulations, international principles, credit policy and other laws such as land code, civil code, etc. In KCB, it is the law governed by the commercial court and the law "loi des suretés". For Ecobank it's the central bank BRB by way of circulars.

### **3.3.2 Definition**

The definition of a bank is found on the article 3. It states that banks are legal persons who carry on as their usual profession and mainly the following operations: receipt of funds from the public; credit operations and making available to customers the means of payment and the management of these.

Under article 5, we read that" A credit transaction for the purposes of this Decree shall be any act by which a person acting for consideration makes or promises to make funds available to another person or takes, in the interest of that person , A commitment by signature such as a guarantee, or a bond."

The following are considered to be credit operations and, as such, are placed under the control of the Central Bank: leasing and, in general, any lease with an option to purchase as well as sales financing on credit.

### **3.3.3 Bank's policy regarding lending to companies**

A bank's credit policy defines credit risk management. It sets the general guidelines on which a bank relies to manage the credit granting activity because of the risks associated with this activity.

The definition of a credit risk management policy is very important because it aims to ensure, firstly, that depositors can at any time recover funds entrusted to the bank and that the latter has lent to third parties at its own risk and perils; to then ensure the profitability of the bank.<sup>127</sup>

Credit policy is limited in the context of credit risk management. Its purpose is to provide the principles applicable to credit activities.<sup>128</sup>

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<sup>127</sup>Credit policy of BCB (Politique de crédit de la BCB)

<sup>128</sup>Ibid.

### **3.3.4 Types of loans offered by the Bank**

#### **a. Disbursement credits**

It's all credit that involves an outflow of funds. They include: the operating credit also called cash credit, investment credit and rolling stock equipment (real estate and furniture, etc.) as well as credit for the purchase of raw materials.<sup>129</sup>

#### **b. Signature credits**

This is credit that does not involve the release of funds; the bank gives a guarantee of payment, it is the documentary credit guarantee on the import or the export. By guarantee we can understand for example a construction where the bank guarantees the start advance and the good end of the work, etc. in other words, the bank agrees to pay if the company does not honour its commitments to the third party.

The institution on which banks rely to enforce their obligations are based on the banking law which is the BRB's regulations, the international principles, the credit policy and other laws such as land code, civil code, etc.

### **3.3.5 Lending criteria**

To the question "How does the bank determine which company to lend money to?" the answer is that the bank can only grant loans to clients that it knows and can only finance legal and transparent transactions. This means that banks allow credit to their customers. As mentioned below in the conditions of granting loan, it is mandatory to have an account in the bank in which a company is requiring a credit.

The activity financed must be located in the national territory and the bank must ensure that this activity will be able to repay the credit granted. In addition, only good clients can obtain credit, but adjustment credits can be granted provided that the bank is covered by real guarantees; this to reduce the risk of non-reimbursement.

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<sup>129</sup>Ibid..

The bank finances all sectors of activity such as companies (small, medium or large), individuals (traders or employees in both the public and private sectors) and professionals (lawyers, doctors, etc.).

Bankrupt customers are not eligible for financing, clients who have not paid back in capital or interest in the past and all clients excluded by the competent body in the decision to grant credit.<sup>130</sup>

In other banks like Ecobank Burundi, the criteria are almost the same with those in BCB. The bank analyses first; turnover; verifies if the company produces the balance sheet; if the business is profitable and finally the guaranties. For this last analysis, the company must first have an account in this bank for the latter to analyse the frequencies of the movements on the account. The bank also analyses financial strength, hence the importance of balance sheets. It also verifies that the steps / order form are authentic.<sup>131</sup>

The Ecobank Group is committed to promoting good corporate governance because it believes that good governance can increase shareholder value. Ecobank was one of the first companies to institutionalize the principles of good corporate governance in Africa and integrate them into its corporate culture.<sup>132</sup>

In KCB the criteria are the following: domiciliation of the account in the bank in which the client aspires to apply for a credit, verification by the bank of the existence of the business, verification and confirmation by the bank of the existence of the shareholders, presentation of a tax identification number, business register and its statutes.<sup>133</sup>

### **3.3.6 Policy for recovery of outstanding debts**

The granting or the distribution of credit, being one of the main services offered by the bank to its customers and also one of the most generators of profit for her, can be revealed source of important expenses for the bank in the absence of a good

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<sup>130</sup>Bank procedures and credit policy of the BCB (Procédure bancaire et Politique de crédit de la BCB)

<sup>131</sup> *Circulaire de la banque centrale du Burundi BRB*

<sup>132</sup> Groupe Ecobank Rapport Annuel 2013, p 64

<sup>133</sup> Information provided by a credit officer at KCB Bank Bujumbura

knowledge and a perfect control of the risks inherent to this type of service (or operation), resulting in considerable negative impacts on its results.

To do this, in order to avoid or minimize these risks, the occurrence of which may lead to the transformation of the bank's liabilities, it is first of all necessary to have a perfect knowledge of the legal and regulatory regimes of bank credit, of the objectives well defined. Good separation of credit analysis and management structures and efficient recovery methods; good provisioning policy; an effective reporting system for actions taken by credit management structures; finally an excellent interaction between the different structures of the bank.

### **3.4 The importance of credit in corporations**

Credits are very important in the economy; they establish a specific relation between the bank and the receiver. A credit agreement is defined as an "agreement to lend or forebear repayment of money, goods, or things in action, to otherwise extend credit, or to make any other financial accommodation."<sup>134</sup> Burundi has a relatively small, undeveloped financial sector that is dominated by banking. The Government retains stakes in several banks. This make Bank finance the main source for companies in Burundi.<sup>135</sup>

### **3.5 The conditions of granting loan**

In Burundi, the central Bank is the one which provide rules of conduct for other banks. The Banque de la République du Burundi( B.R.B) sets the limits and some conditions to protect the banks because it is the money of the citizens that would be lost if the bank were to fail. This two articles 5 and 6 on the conclusions on credit risk <sup>136</sup> show that the control carried out by the Council Administration and Management direction of banking institutions has to:

First establish whether the institution has a credit control team which is independent and regularly monitors the Situation and re-evaluates individual credits, their commitments and their ratings.

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<sup>134</sup> Dixon v. Countrywide Fin. Corp., 2009 U.S. Dist. LEXIS 101451 (S.D. Fla. Oct. 16, 2009).

<sup>135</sup> See Deloitte &Touche, Burundi Economic Outlook (2016 report) 10.

<sup>136</sup>Banque de la Republique du Burundi service supervision des Etablissements Bancaires et Financiers et Stabilite Financiere, available on <http://www.brb.bi>.

Second, ensure that the independent control team performs the work this way: Performs regular formal checking and carries out Rating of individual credits; assess the current financial situation of borrowers; ensure that the safeguards are maintained; ensure that the appropriations comply with the terms and Loan terms and conditions; analyses the situation of appropriations rapidly and Reclassification if necessary; Provides current information on the quality of the Credit portfolio

### **3.5.1 The conditions of granting loan in BCB (Bank of Credit of Burundi)**

The documents required for the granting of credit, in the case of a business: There is first a credit application letter, a history of the account to show the turnover; then he is asked if there is a business plan of his business especially if it is a new investment, then the financial statements to analyse the demand.

Then there is the warranty stage, which may be a title to a parcel built or not, it can also be a pledge of deposits, downstream by a third party, downstream supported by a mortgage on land or a house that is a guarantee from another bank.

Sometimes the credit is refused to the applicant. In general, the reason for refusal is the client's inability to repay the credit. If after analysis it is found that the client runs the risk of not being able to prosper and repay or if the demand do not fall within the domains that the bank finances, the credit is refused. The bank must also follow its clients through field visits by "tracking repayments." <sup>137</sup>

### **3.5.2 The conditions of granting loan in Ecobank Burundi and other banks**

The conditions required for the granting of credit in Ecobank are: the opening of an account; regular diet of the account; the domiciliation of payments and the mortgage guarantees.<sup>138</sup>

At the KCB bank, they add on this list the fact that the bank must be able to verify the existence of the business, it must verify and affirm the existence of shareholders, and the company must also present a tax identification number, a business register and its statutes. The KCB bank of Burundi basically finds its

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<sup>137</sup>Bank procedures and credit policy, BCB.

<sup>138</sup> *Circulaire de la banque centrale du Burundi BRB*

references on the laws governed by the commercial court (cfr the law of the securities).<sup>139</sup>

As for BANCOBU, its criteria, conditions, control system and others, are mainly derived from the circular of the central bank n12.

### **3.6 Conclusion**

By presenting the different laws existing on companies and banks, the researcher helps the reader to know more about the subject. The analysis of the conditions of lending in different banks, their lending criteria and the rules and regulations used by them to maintain a good follow-up on the borrower company, shows that most of the banks have similar conditions. This shows that the central bank of Burundi plays an important role which is to regulate and provide conducive rules to all the commercial banks.

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<sup>139</sup> Information provided by a credit officer at KCB Bank Bujumbura

**Table 1. Burundian Financial System: commercial banks<sup>140</sup>**

No	Name of the bank	Social capital	Type
1	Banque de Credit de Bujumbura (BCB)	13,000,000,000 BIF	Mixed society
2	Ecobank Burundi	10,500 187,632 BIF	Public limited company
3	Banque Commerciale du Burundi BANCOBU	10,010 000,000 BIF	Mixed society
4	Banque de Gestion et de Financement BGF	11,659 800,000 BIF	Public limited company
5	Banque Burundaise pour le Commerce et l'Investissement BBCI	15,000,000,000 BIF	Mixed society
6	Finbank	10,065,800,000 BIF	Public limited company
7	Interbank Burundi IBB	20,484,800,000 BIF	Public limited company
8	Daimond Trust Bank Burundi DTB	11,000,000,000 BIF	Public limited company
9	KCB Bank Burundi Limited	15,692,000,000 BIF	Public limited company
10	CRDB Bank Burundi	14,692,800,000 BIF	Public limited company

The presentation of table 1 helps the reader to know the different banks we have in Burundi; the social capital of each of them, helps getting more information about the financial system health and finally the different types of commercial banks we have in Burundi.

<sup>140</sup> BRB, "Burundian Financial System: The Commercial Banks" (in French). Bujumbura: Bank of the Republic of Burundi (BRB). Retrieved 14 April 2016.

## **CHAPTER FOUR**

### **RELATIONSHIP BETWEEN BANK FINANCING AND CORPORATE GOVERNANCE**

#### **4.0 Introduction**

This chapter illustrates the interrelationship between bank finance and corporate governance in Burundi and attempts to provide empirical evidence of the role of banks in the Burundian's corporate governance system. The researcher reviews the empirical research that explores this relationship she also seeks answers to some questions like if there is a relationship between board structure and performance to find at the end of the day that there is a link between Corporate Governance and the Performance of the company.

The chapter specifically examines how banks, as the major source of finance for companies in Burundi, monitor companies to whom they lend money, and how the monitoring impacts corporate governance. The researcher also discuss in this chapter, the limitations to the governance role of banks and the importance of credit in corporations.

Moreover, the researcher is linking bank finance to corporate governance by demonstrating the various ways in which bank finance impacts corporate governance in Burundi. this discussion focus on describing the interface between banks and companies in Burundi, prior to obtaining finance, during and after the period of the loan and the resultant impact on corporate governance at each stage.

#### **4.1 Bank Monitoring Mechanism**

In addition to operational constraints and financial covenants, the bank keeps tabs on the borrower by requiring it to produce a steady stream of information to the bank in the form of periodic financial and operating reports. This information is far more timely and detailed than any regular public disclosure the borrower firm may be required to make. The bank also typically enjoys direct access to firm management to address any concerns it might have. Banks therefore enjoy far better information about a firm than individual or even institutional investors. With

its periodic reports, the firm must also certify its continuing compliance with each specific condition and restriction contained in the credit agreement. For example, in addition to producing quarterly financial statements, the firm may be required specifically to certify its net worth, tangible assets, cash flow, or other accounting benchmarks in order to confirm its compliance with individual financial covenants. Besides these regular reports, the borrower obligates itself to provide notice to the bank of the occurrence of any of a number of unfortunate incidents that might adversely affect the borrower's creditworthiness – material litigation, a default or potential default on the loan, or receipt of a government notice of a material regulatory violation, for example.<sup>141</sup> In addition to contractual constraints and ongoing reporting, the bank often has a representative on the borrower's board of directors, which offers one more avenue for active monitoring.<sup>142</sup>

Monitoring is considered as one of the bank's most distinctive and important activities as said Freixas and Rochet. In general, the purpose of bank monitoring is to reduce a bank's credit risk by preventing the opportunistic behaviour of a borrower.<sup>143</sup>

Banks also enjoy institutional features that facilitate monitoring. They typically offer cash management services to their borrowers, who are often required to maintain their deposit accounts with their bank lender.<sup>144</sup> This arrangement enables a bank to closely follow its borrower's aggregation and use of cash in real time, giving the bank a clear window on the borrower's business activity. Bank lending practices also facilitate monitoring.<sup>145</sup> Bank lending is ordinarily only short-term or medium term, which means borrowers must periodically renew their bank lending arrangements. This gives the bank fresh opportunities to re-examine its borrowers' creditworthiness, and also gives borrower managers incentive to maintain creditworthiness.<sup>146</sup>

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<sup>141</sup> SungyoonAhn, Wooseok Choi \*,The role of bank monitoring in corporate governance: Evidence from borrowers' earnings management behaviour, journal homepage: [www.elsevier.com/locate/jbf](http://www.elsevier.com/locate/jbf), 2009, p 425.

<sup>142</sup> idem

<sup>143</sup> idem

<sup>144</sup> See the credit policy of Bank of Credit of Bujumbura (BCB).

<sup>145</sup> idem

<sup>146</sup> idem

As detailed below, the bank typically imposes numerous periodic and special reporting requirements on the borrower.

As far as operational constraints, negative covenants prohibit the firm from engaging in certain transactions without the bank's consent. For example, the firm's latitude to incur new debt, make investments or distributions, engage in transactions with affiliates, sell substantial assets, give liens on its assets, merge, or change the nature of its business, may all be explicitly restricted in the loan agreement. Use of loan proceeds is restricted. In addition to operational restrictions, financial covenants generally require the firm to maintain a healthy financial condition. It must, for example, preserve certain levels of net worth, tangible assets, total capital relative to debt, or cash flow relative to debt service obligations.<sup>147</sup>

Reviewing a borrower's probability of default is basically done by evaluating the borrowers' current and future ability to fulfil its interest and principal repayment obligations.<sup>148</sup> This evaluation has to take into account various characteristics of the borrower (natural or legal person), which should lead to a differentiation of the credit approval processes in accordance with the borrowers served by the bank.<sup>149</sup>

Furthermore, it has to be taken into account that for certain finance transactions, interest and principal repayments should be financed exclusively from the cash flow of the object to be financed without the possibility for recourse to further assets of the borrower. Then, it is necessary, as stated in the Guidelines on Credit Risk Management, to include the source of the cash flows required meeting interest and principal repayment obligations when such case happen.<sup>150</sup>

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<sup>147</sup>U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C., 864 A.2d 930, 943 (Del. Ch. 2004).

<sup>148</sup>ROBERT SILIKHE SIMIYU, A SURVEY OF TECHNIQUES OF CREDIT RISK MANAGEMENT IN MICRO-FINANCE INSTITUTIONS IN KENYA, NOVEMBER 2008, P 16.

<sup>149</sup>idem

<sup>150</sup>Guidelines on Credit Risk Management, Credit Approval Process and Credit Risk Management, p 12 .

#### **4.1.1 Mechanisms used by banks to monitor companies**

At the bank Ecobank, control is by consulting the accounts from day to day to avoid unpaid. The control is also done by regular visits to companies to which the bank has granted credits in order to monitor the business of these companies. There is also regular monitoring of bills being paid. The domiciliation of payments in the bank is also an important tool.<sup>151</sup>

Winnifred in her study has specified numerous monitoring mechanisms used in Uganda. Some of them also apply to banks in Burundi; "The periodic review of financial information" as indicated earlier, is an obligation for borrower corporations. They are asked to submit periodic financial information to lenders. The loan agreements typically require companies to submit quarterly management accounts, semi-annual and annual financial statements.<sup>152</sup>

Here we see the importance of the loan agreement. In its absence, there would be no liability against the borrower if he fails to provide the financial information required.

"Inspections" is also an important mechanism. Information gathered from the inspections is used to verify the submissions made by the borrower and to note any "red flags" that may indicate problems and require lender intervention. In cases in which the company is in financial distress, the inspections are conducted more frequently, subjecting the company to strict or closer scrutiny.<sup>153</sup> This mechanism is not frequent in Burundi. However, it is important and shall be taken into consideration by the concerned people.

The "representation on the board of directors" is another important mechanism<sup>154</sup> which, unfortunately, is not practiced in large scale. Commercial banks typically do not appoint representatives to the boards of companies that they lend money to. It would be effective if sometimes banks would require a representative to be appointed to the board of directors of a borrower company. We should note that in

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<sup>151</sup> Circulaire de la banque centrale du Burundi, BRB.

<sup>152</sup> Winnifred Mary Talinyeba, op. cit., p 50.

<sup>153</sup> Idem.

<sup>154</sup> Idem. p 52

jurisdictions, such as Germany, board representation is a key monitoring tool used by banks.<sup>155</sup>

#### **4.1.2 The effectiveness of bank monitoring**

As stated in the previous sections, borrowing firms have incentives to manage earnings around debt financing, and the firms' earnings management is important for banks' credit risk management. Therefore, banks perform monitoring activities to provide borrowers with incentives to avoid earnings management, thereby reducing credit risk. Compared to individual lenders and other specialized agencies including auditors, banks have comparative advantages in monitoring borrowers because of their low costs of delegation, economies of scale in monitoring, abilities to access inside information, etc. The banks' superior monitoring abilities have been the subject of many academic studies.<sup>156</sup>

It has been demonstrated that the system through which bank financing can apply a certain control on corporate governance is the system of monitoring. To the question does the monitoring mechanism employed have a long term impact on the management of the companies, the answer is yes the follow-up of the company and the know your customer can oblige or force the company to work according to the principles of good governance and good management because otherwise, it will not have credit in the banks.

In different banks of Burundi, the system of control used monitoring which is done in different ways. In BCB for example, each year the company sends the banks its financial statements or every six months; it makes regular visits to collect the needs of the client and know his strengths and weaknesses in order to build loyalty.<sup>157</sup>

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<sup>155</sup>Peter O. Mulbert, *Bank Equity Holdings in Non-Financial Institutions and corporate governance: the case of German Universal Banks, in comparative corporate governance*, (Klaus J. Hopt, ed. 1998).

<sup>156</sup>SungyoonAhn, Wooseok Choi , op.cit., p 426.

<sup>157</sup> Bank procedures and credit policy BCB.

In Ecobank, the committee does this by consulting the accounts from day to day to avoid unpaid bills; it also makes regular visits to companies to which they have granted a credit, they also do the regular monitoring of invoices being paid.<sup>158</sup>

#### **4.1.3 The bank's monitoring responsibility toward the company**

Monitors should expect companies to implement organizational structures; ensure that boards and senior management of one person companies have in place processes to fulfil their responsibilities; Hold the board accountable for any problems detected and require timely corrective measures; be attentive to any signs of deterioration in management; consider issuing guidance to companies on sound corporate governance.<sup>159</sup>

In case of insolvency on the part of the company for example, the requirement or the strategies to recover the loan in Burundi is found in Art.71 of the Companies code. It states that the liquidator is appointed by the shareholders or, failing that, by a court decision.<sup>160</sup>

The initiation of the reorganization will give rise to the appointment of one or more administrators responsible, together or separately, to assist the company for all acts relating to its management or some of them or to ensure, or in part the administration of the company.

During this period, the tasks entrusted to the managers of an undertaking in receivership are mostly the communication of certain documents;

As soon as the judicial reorganization proceedings are initiated, the court will appoint an auctioneer to carry out an inventory of the debtor's assets and the guarantees that will affect him. The administrator will be obliged to perform all the necessary acts to preserve the rights of the debtor and to preserve his productive capacity (mortgage, collateral, etc.).

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<sup>158</sup> Interview with keza Joelle; Head of Credit; ECOBANK Bank Burundi, information received in November 2017.

<sup>159</sup>Sarkis D. Yoghourtdjian, *Corporate Governance in the Banking, Sector: Issues & Challenges* 27.

<sup>160</sup>Art 71 of the Companies code, op. cit."The liquidator is appointed by the partners or failing that, by court order. "

The debtor will have to communicate to the court several documents: the certified list of creditors, the amount of its debts and the principal contracts in progress; the list of the different establishments, the staff and all the elements making it possible to know the salaries and allowances to be paid; the list of trials in progress.

During the observation period, the company continues its activity. Each month, the company will have to prepare an income statement and an activity forecast, certified by a public accountant, for the periods after the opening of the judicial redress procedure. It must be sent to the judge-commissioner.

The shareholders are convened at the end of the liquidation to decide on the final account, the discharge of the management of the liquidator and the discharge of its mandate and to note the closure of the liquidation.<sup>161</sup>

In Burundi, the follow - up is done in the following way: every year or every six months, the company sends to the bank its financial statements. The bank, on its part, must make regular visits to gather the needs of the client and to know its strengths and weaknesses in order to retain it.<sup>162</sup>

We find in this chapter that the system of monitoring is one of the tools used by banks to keep tabs on the way companies are performing in the line of their corporate governance.

## **4.2 The role and rights of creditors in corporate governance**

"Creditors have some control rights in companies and hence are also important players in corporate governance. Creditors could influence major decisions of the companies and discipline bad management through a variety of controls they have when companies default or violate debt covenants. Their influence exists also because they lend short term and borrowers have to come back at regular, short intervals for more funds".<sup>163</sup>

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<sup>161</sup>Art 74. Companies code, op. cit.

<sup>162</sup>Bank procedures and credit policy BCB.

<sup>163</sup> Juzhong Zhuang, *SOME CONCEPTUAL ISSUES OF CORPORATE GOVERNANCE*, [ADB, EDRC Briefing Notes Number 13], (June 1999) 6.

Those who apply for bank loans and those who issue corporate bonds both have contractual payment obligations, promising to make predefined, on-going, future payments to lenders.<sup>164</sup> However, creditors may also have rights over business decisions made in solvent states. The example of what they could do is: imposition of sanctions on a company's investment policy, including mergers and acquisitions and spin-offs, and the imposition of restrictions on the overall level of borrowing from the company and, if it is close to insolvency, on dividends and other decisions that could affect their security.<sup>165</sup> In case of breach of commitment by the borrower and, in particular, default on a payment, the lender obtains certain rights, such as the possibility of repossessing certain assets of the firm (guarantee) or the possibility of disposing of the company in bankruptcy.<sup>166</sup>

There are practical requirements that bank demand to ensure the sustaining role in corporate governance; we find out that the rights of the creditors are reflected in these requirements:

Starting by information; it is the first requirement that Lenders need. They need it on the creditworthiness of potential borrowers, and depositors and bank supervisors need information on bank portfolios.<sup>167</sup> Information is also a right for creditors because information about the accounting document of the company should allow the creditors to interpret the finest default by a company, in that case if that company has a small chance of recovery the role of the bank will be to bring suggestions of maybe replacing the external auditors, appointing new directors, etc.

The following is creditor incentives: The second requirement for debt to serve a control function is the existence of appropriate market-based incentives for creditors, whether banks, trade creditors, or government.<sup>168</sup>

The other one is the debt collection: The third requirement for creditor monitoring and control in a market economy is an appropriate legal framework and effective procedures for debt collection. Without an effective system of debt collection,

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<sup>164</sup> Ibid. 7

<sup>165</sup> Ibid.

<sup>166</sup> Ibid.

<sup>167</sup> CHERYL W. GRAY, Creditors' Crucial Role in Corporate Governance, [Finance & Development / June 1997]30.

<sup>168</sup> Ibid. 31

debtors lose repayment discipline, the flow of credit is constrained, and creditors may be forced to turn to the state to cover their losses if they are to survive.<sup>169</sup>

There should be for creditors the right to attend general meetings in the borrowers companies. In that case, maybe, instead of liquidating the company they may stay around to deal with those situations that created the default.

In OHADA, for example, it is provided that creditors have to attend general meetings in the company in an advising capacity. This should lead the creditor to know and to have an understanding of the financial situation of that particular company.

The loan must be secured by a fixt charge. The rights of a creditor should also help him get the priority in terms of appointing a liquidator in case of insolvency for example.

Other kind of rights of creditors may be found in their requirements or obligations to the company in terms of the loan agreement.

Banks typically have lending requirements or appraisal criteria to determine whether to advance money to a borrower or not. In Burundi, enterprises have the right to apply for trade and investment credits if they so desire. An enterprise must first be legally constituted; that is to say in accordance with the Burundian law on the creation of companies.<sup>170</sup> The company must then be a customer of the bank, that is to say have an account. Secondly, the purpose of the credit must relate to the acquisition of the goods not prohibited in Burundi or to finance a non-prohibited activity. The company must also present its financial statements to see if it is not a troubled or bankrupt company. If it is a new investment, a business plan must be presented to analyse the project's profitability. Also ensure that the proposed activity will allow the repayment of the credit. If it is an operating credit analyse whether the company generates profits allowing repaying the credit.<sup>171</sup>

Therefore, the eligibility criteria for loans, has a disciplining effect on directors and controlling shareholders of companies in Burundi for example, analysing the ability of

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<sup>169</sup> Ibid. 32

<sup>170</sup> Law n ° 1/09 of 30 May 2011 on the Code of Private Companies and Public Participation.

<sup>171</sup> Bank procedures and credit policy Bank of credit of Bujumbura (BCB).

managers to manage the company well, verifying that they don't have other credits in other banks, also seeing if the activity is not at risk, also analysing the market to see if there are any competitors in this area; what is called "market risk". In addition to all this, at the BCB they analyse the operational risk verifying whether the activity in itself can be realizable and generate profits.<sup>172</sup>

Therefore, the role of banks starts at the initial stages of corporate finance. Winifred says that the conduct of directors and controlling shareholders and their duties towards the company and its shareholders should, ideally, be the realm of corporate law and fiduciary duties enforced by courts.<sup>173</sup>

For the *Banque de Credit de Bujumbura* (BCB), the criteria are the following; having an account in the bank; can only finance legal and transparent transactions; The activity financed must be located in the national territory and the bank must ensure that this activity will be able to repay the credit granted; Bankrupt customers are not eligible for financing.<sup>174</sup>

In KCB Bank Burundi Limited it is; the domiciliation of the account in the bank in which the client aspires to apply for a credit; verification by the bank of the existence of the business; verification and confirmation by the bank of the existence of the shareholders; presentation of a tax identification number, business register and its statutes.<sup>175</sup>

Ecobank Burundi: analyse of the turnover; verifies if the company produces the balance sheet; if the business is profitable and finally the guaranties; it also verifies that the steps / order form are authentic.<sup>176</sup>

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<sup>172</sup> Ibid.

<sup>173</sup> Winifred Mary Tarinyeba, *Corporate governance in Uganda: the role of bank finance*, (may 2006) 46.

<sup>174</sup> Bank procedures and credit policy Bank of credit of Bujumbura (BCB).

<sup>175</sup> Information provided by a credit officer at KCB Bank Bujumbura.

<sup>176</sup> Interview with keza Joelle; Head of Credit; ECOBANK Bank Burundi, information received in November 2017.

**Table 2: Observation table of the implementation of certain components of good corporate governance<sup>177</sup>**

Name of the bank	Financial statement	Legal constitution	Representation in board meetings	Reputation and reputation risk
BCB	✓	✓	—	✓
KCB	✓	✓	—	✓
ECOBANK	✓	✓	—	✓
CRDB	✓	✓	—	✓
BANCOBU	✓	✓	—	✓

This table can be explained as follow: in the various banks visited by the researcher, she noticed that the various elements constituting good corporate governance were observed there. However, none of the banks insists on the representation in the board meetings, except for the CRDB which requires it in its other banks located elsewhere than in Burundi. The main reason is that few companies in Burundi have a board meeting of directors which is effective.

Other elements such as the presentation of the financial statement, the verification of the legal constitution of the company as well as the reputation of the company, are required under all credit conditions of these different banks.

CRDB bank has also an interesting way of monitoring the companies they lend money to: "internally, they have a system which generates report on daily basis. The bank monitors those companies through that report. If it happens to be in arrears for one day, the system will report. The bank also monitors by doing regular visits to their businesses and also they visit collaterals pledged to secure the loan on regular basis."<sup>178</sup>

<sup>177</sup> Information obtained by analysing the answers to the questionnaire presented in different banks

<sup>178</sup> Interview with Deus dedit Mchomba, Head of Credit; CRDB Bank Burundi S.A. (27th Jan 2018)

### **4.3 Conclusion**

The mechanism used by banks to maintain the relationship between companies and bank financing is the system of monitoring which by its different aspects or roles prove to be very important in influencing good corporate governance in given companies.

Most of the time it is done by consulting the accounts from day to day to avoid unpaid; by regular visits to companies to which the bank has granted credits in order to monitor the business of these companies. There is also regular monitoring of bills being paid. The domiciliation of payments in the bank is also an important tool used by banks to monitor companies they lend money to.

## **CHAPTER FIVE**

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1. Summary**

The researcher found out that Laws and Rules regulating Companies and bank financing in Burundi are well established however their enforcement still need to be improved.

The legal intersection between corporate governance and bank financing is mostly about the monitoring system. That one is effective in some banks like in Bank of Credit of Bujumbura (BCB) but it is less effective in others. The lending criteria are almost the same in the different banks analysed and they all consist in providing securities so that the bank shall be assured of the creditworthiness borrower company.

Regulations on bank financing in Burundi do not specify clearly the rights of creditors, which rights should encourage them to lend more. The influence that bank financing has on corporate governance in Burundi is obvious and should be better if the existing rules were enforced.

##### **5.1.1 Corporate governance situation in Burundi**

Burundi has a substantial infrastructure deficit that constitutes a serious obstacle to its development, as confirmed by the Bank's 2009 Infrastructure Action Plan. The country is behind the other EAC members concerning access to basic infrastructure.<sup>179</sup>Corporate governance is a new concept which is not practiced at all, however the good thing is that Burundi have a good potential and many examples to follow when it will be making its first steps to an effective corporate governance system.

##### **5.1.2 Threats to good corporate governance in Burundi**

The biggest issue that corporate governance faces in Burundi is the lack of appropriate materials and laws on the subject; however, even those which are there

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<sup>179</sup>Bank's Infrastructure Action Plan (2009) 10.

are not properly enforced. Another thing is the poor economic sector that causes the peculiarity of companies in that country.

In Burundi, we cannot be fooled by the fact that the annual reports presented by the CEP on the management of public companies show an alarming situation on their excessive and growing debt from year to year. However, the factors contributing to this state of affairs are in most cases related to the inadequacy of economic policy and management.<sup>180</sup> This should encourage public authorities to think more about how to push public companies to more profitability. Some management specialists even say that; "Given the selfish nature of man, no manager of a public company will run the firm as effectively as a managing owner would have done if it is his own business".<sup>181</sup> This shows how the fiduciary duty is important for directors, because the relation between a director and the company is a fiduciary one. As we saw it in class, "the critical feature of a fiduciary relationship is that the fiduciary undertakes to act for or on behalf of the interests of another in the exercise of a power or discretion which will affect the interests of the other person. Fiduciary relationship seeks to protect the beneficiary by requiring him to act, if he acts at all, to promote and protect his beneficiary's interests."<sup>182</sup>

Good corporate governance is not an end in itself. It is a means to create market confidence and business integrity, which in turn is essential for companies that need access to equity capital for long term investment.

### **5.1.3 Board composition**

The board of directors shall be composed by a balance of executive and non-executive directors; non-executive directors should comprise the majority; a nomination committee, consisting entirely of non-executive directors, with the majority independent directors and chaired by the board chairman, is to select

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<sup>180</sup>Salvator NYANDWI, *Analyse des déterminants de la faillite des entreprises publiques burundaises: cas du Complexe Textile de Bujumbura( COTEBU )*[Analysis of the Determinants of Bankruptcy of Burundian State Enterprises: Case of the Textile Complex of Bujumbura] (COTEBU, 2013) 12.

<sup>181</sup> CEP, "Report of an ad hoc committee of COTEBU workers", (November 1996).

<sup>182</sup>Notes provided in LLM commercial Law class by Jimmy Walabyeki.

directors in a transparent manner; rotation of directors, to ensure continuity, is important.<sup>183</sup>

## **5.2 Findings**

There are some ways that the Government has put in place as an effort on his behalf to make financial services and products<sup>184</sup> accessible to all categories of the population. The NFIS is one of them.<sup>185</sup>

### **5.2.1 The National Financial Inclusion Strategy (NFIS)**

The NFIS proposes a series of measures that require a commitment on the part of the country's authorities and the participation of stakeholders to supervise the demand for or the supply of financial services and products.<sup>186</sup>

Burundi, through the Bank of the Republic of Burundi (BRB) and the Ministry of Finance and Economic Development Planning, is a member of the Alliance for Financial Inclusion (AFI) since May 2009. AFI is a global network of policymakers from developing countries, created in September 2008 by the German Technical Cooperation Agency (GTZ) and funded by the Bill & Melinda Gates Foundation. The mission of this alliance is to provide policymakers with the tools and resources needed to enable the economically active poor to have greater access to formal financial services and products and thereby take advantage of their enormous economic potential.<sup>187</sup> The NFIS is a good strategy. It targets the financial sector, including banks and microfinance, but since it concerns demand the proposed actions also involve the agricultural sector and business development.

In the context of Burundi, financial inclusion can be defined as: "Permanent access by the adult population to a set of financial products and services (i) offered by formal and sustainable financial institutions, governed by adequate regulations, (ii) that are diversified, affordable and adapted to the needs of the population, and (iii)

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<sup>183</sup>See the summary of code of corporate practices and conduct n Brian Coyle, p 337.

<sup>184</sup> Where the expression financial services and products is employed, it refers to the financial services and products offered by formal financial institutions.

<sup>185</sup>Ministry of Finance and Economic Development Planning, National Financial Inclusion Strategy (NFIS) 2015-2020, October 2014, p5.

<sup>186</sup>Ministry of Finance and Economic Development Planning, National Financial Inclusion Strategy (NFIS) 2015-2020, October 2014, p5.

<sup>187</sup>Idem.

used by the latter for the purpose of contributing to the improvement of the conditions of their socioeconomic life.”<sup>188</sup>

A comprehensive approach to financial inclusion includes at least three elements; the first would be the access to financial services and products; the second would be the usage of the financial services and products and the last is the quality of the financial services and products, defined by the capacity of the consumers to benefit from them and the related aspects of consumer protection and financial education.<sup>189</sup>

### **5.2.2 Current status of financial inclusion**

The Rural Microcredit Fund (FMCR) and a dozen MFIs are already committed to spreading this approach.<sup>190</sup> In addition, nine COOPECs affiliated with FENACOBUR are testing this type of credit. Burundians can hope that with significant support, this approach could expand rapidly and cover the entire country. The FMCR already provides this type of technical assistance. It is undoubtedly the way to have the greatest impact on the majority of the population. The expansion of this type of credit will eventually require refinancing for the structures that provide it. <sup>191</sup>

## **5.3 Recommendations**

The recommendations the researcher may bring out of the previous findings are that, coaching is necessary for some structures such as the Burundi Business Incubator (BBIN), Université Lumière and the Federal Chamber of Commerce and Industry (CFCI) which are involved in financial education and coaching for small entrepreneurs. In some cases, other accompanying measures are planned, such as access to credit lines with concessional rates or loan guarantees. These efforts and accompanying measures must be increased in order to make small companies more eligible for loans. To this end, the Association of Banks and Financial Institutions

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<sup>188</sup>Ministry of Finance and Economic Development Planning, National Financial Inclusion Strategy, Ibid. p7

<sup>189</sup>Ministry of Finance and Economic Development Planning, National Financial Inclusion Strategy, ibid, p7

<sup>190</sup>ISHAKA, UCODE, Twitezimbere, COSPEC, Hope Fund, CECM, WISE, CCI-ODAG, TURAME.

<sup>191</sup>Ministry of Finance and Economic Development Planning, op.cit., p 11

(ABEF) is promoting a project to support financing for small companies via the Impetus Guarantee and Support Fund (FIGA).<sup>192</sup>

Basing on the research findings, especially on the gaps existing in the laws and policies regulating the companies and the banking sectors in Burundi, other recommendations have been forwarded such that corporate governance in Burundi can be improved and widely practised.

There is a need to reform the legal framework and also the need to reform the institutional framework:

### **5.3.1 Need to reform the legal framework:**

- Need to amend the companies code of Burundi which is too old and by consequence can't reach some important points because a society is something which keeps on evolving.
- Need to fight against corruption in all the sectors because in Burundi, Corruption is also among the reasons which refrain from investing.
- Need to give bank credit the spending of its budget. These resources are essential to the quality of its work. Current controls do not permit the banking sector to exert the system of monitoring effectively.
- Need to create a public registry of EAC laws, regulations, and instructions, including standardized forms to be used in commerce. There is already a good website by the EAC institutions, but the legal information available is not complete and is restricted to legal text. Access by users to legal instruments and interpretations is a basic condition defining compliance and the effectiveness of a regulatory framework.

### **5.3.2 Need to reform the institutional framework**

- Need to create in commercial banks a dedicated mechanism, with adequate resources, expertise and authority, to assist in the development of the regulatory

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<sup>192</sup> Ibid. p 13

strategy. This is required for managing and coordinating implementation of the regulatory reform strategy; and monitoring and reporting on outcomes.

- Need to initiate training program in good regulatory practices to build awareness and skills among the directors and shareholders of companies
- Need to take low-cost and concrete steps to increase communication and awareness of the requirements according to granting loans by the bank to the borrower company
- Need to mandate stakeholder consultation for all significant regulatory changes. A systematic consultation process for all regulatory drafts will at a stroke increase the transparency of the economic structure and bring in new voices whose views are important to the success of good corporate governance.
- Need to adopt and implement the regulatory principles needed for the functioning of companies in Burundi. This can be done by adopting substantive regulatory quality principles such as transparency, openness, accountability, responsibility, fairness, etc. and creating procedural safeguards to implement those quality principles.

We have seen above, different conditions of granting loan of different banks in Burundi; all these requirements of the bank towards the company constitute, if they are respected, a good corporate governance as it is specified by Dr.Tebi Mbeli that, corporate governance generally aims at setting out processes, structures and mechanisms for controlling companies with keen emphasis on disclosure, dividend pay-out, bonuses, performance of directors and their remuneration and the need for shareholders to assume more proactive roles as owners.<sup>193</sup>

That said a company with good corporate governance will not be in the bad condition of being denied credit.

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<sup>193</sup> Valentine Tebi Mbeli, op.cit., 7.

## 5.4 Conclusions

The Bank, according to the corporate governance strategy<sup>194</sup>, shall assist individual firms to develop best practice in corporate governance by according them more favourable terms for access to its resources. In addition, the Bank shall assist financial institutions toward the adoption of corporate governance principles by their clients as a condition for financial support. The Bank will use these institutions to disseminate and promote the adoption of corporate governance principles, especially among SMEs, by linking transactions (loans etc.) to such principles.

It is clear that as long as other forms of corporate finance remain undeveloped in Burundi, banks will continue to serve an important corporate finance role.

At the end of this study, the researcher found that the same observation that Tarinyeba made in her research on corporate governance in Uganda<sup>195</sup>, is applicable in Burundi. In addition, the number of issues that currently constrains the governance role of banks and which need to be addressed, including:

- The access to a quality of information: the governance role of banks arises from their monitoring role as lenders. However, for banks to perform a meaningful governance role, they must have access to information about the companies that they monitor. Banks cannot effectively monitor companies that they lend money to in the absence of timely and accurate information, especially financial information regarding the borrower's status.

Most of the companies usually provide wrong information especially when their financial conditions are not good. Therefore, it is important that the nature of accounting and financial disclosure standards for companies in Burundi be addressed.

- It is necessary to make the governance role of banks more meaningful. Financial intermediation by banks is still relatively low and access to credit is still a big challenge for most companies. There is a need for a specific policy to encourage banks to lend more and, therefore, to have greater impact on corporate finance and

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<sup>194</sup> AFRICAN DEVELOPMENT BANK, *CORPORATE GOVERNANCE STRATEGY*, (July 2007) 13.

<sup>195</sup> Winifred Mary Tarinyeba, *"Corporate Governance in Uganda: The Role of Bank Finance"* [May 2006] 59.

governance. High interest rates and unstable inflation increase the cost of borrowing and discourage companies from borrowing from banks hence limiting the role of banks.

- The importance of legal reform: bank finance can be supported and enhanced by legal rules. The role of the control mechanisms in Burundi, in particular, bank finance, bank finance would be significantly enhanced by legal reform and the strengthening of institutions on which they rely, such as courts.

However, legal rules alone are insufficient to achieve any desired objective if they cannot be enforced.

The various ways in which banks can intervene in the affairs of a company that they lend money to are usually provided for in the debt covenants, such as the option to recall a facility at any time. Other terms are in the form of undertakings and warranties that the borrower gives to the lender.

In Burundi, bank finance is still an important source of corporate finance. However, the governance role of banks can only be made more meaningful by addressing the obstacles faced by banks as indicated above.

The conclusion we can bring to this work, is that, Burundi has a lot of document on which to refer the day they will start to see the importance of corporate governance. It is among others, the OECD principles of corporate governance which ensure the basis for an effective corporate governance framework.<sup>196</sup> Moreover, while doing a comparative study, the researcher made the conclusion that the company's code of Burundi has many similarities with the Ugandan's company's act.

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

The corporate governance framework should first of all be developed with a view to its impact on overall economic performance, market integrity and the incentives it

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<sup>196</sup> Brian Coyle: op.cit. 322.

creates for market participants and the promotion of transparent and efficient markets.

Secondly, the legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.

Thirdly, the division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.

Finally, supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

Rules on corporate governance are a good starting point in promoting sound corporate governance in Burundi but they are not credible unless they are applied effectively. For this to happen, regulators must have sufficient authority and resources. In summary, the regulatory framework will be ineffective unless there is an enforcement regime that works. The effectiveness of enforcement determines regulators success in achieving disclosure and transparency. The varying degrees of enforceability of rules in different countries suggest that laws and regulations that exist in one jurisdiction may not necessarily be effective in another country. "John Locke wrote that freedom in society means being subject only to laws made by a legislature that apply to everyone, with a person being otherwise free from both governmental and private restrictions upon liberty."<sup>197</sup>

First, what is more important is to know which demographic characteristics a board member possesses, what kind of experience he/she has and what types of behaviour he/she portrays. Therefore, gender, nationality and age diversity are not sufficient to evaluate the effectiveness of a board. One should also evaluate the relevance of the experience of board members to address the main challenges the company is likely to face.

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<sup>197</sup> Stanford Encyclopedia of Philosophy, The Rule of Law (wed Jun 22, 2016).

Another important issue is that the quality of the information that the board gets is a key determinant of its effectiveness. Whether relevant and timely information, presented in a context, with the benchmarks and alternatives identified, assumptions understood and stress-tested, or whether the potential effects of various alternatives on different stakeholders have been taken into account, would have a significant impact on the quality of the board's decision.

Third, the impact of a board's decisions on output measures should be evaluated, not just not inputs such as information quality. Governance is important for the sustainability of value creation. If the model that aims to measure effectiveness of governance does not evaluate the linkages to output measures - not only financial performance, but also lead indicators such as customer, employee, or other stakeholder satisfaction - it would be missing an important dimension.

Boards should also be focusing not only on the business results, but also how business results are obtained. As an outstanding performance could sometimes be due to excessive risk-taking, resulting in a relatively good performance during a particular period, it may not be sustainable. Such an elaborate evaluation of management proposals requires an open and transparent culture, where members are encouraged to challenge assumptions and evaluate alternatives.

Also, as there is a time lag between decisions and their impacts, the board's performance should be evaluated over a period of time, not at a specific time.

Finally, the purpose of measuring the effectiveness of governance should be to improve it continuously. Therefore, assessing how a board learns and invests in developing its own performance should be an important dimension of the model.

The researcher ends up saying that, the form of financial institutions that prevails in Burundi prove to be crucial for the quality of restructuring and adjustment of the industrial sector. The actual evolution of financial systems in Central and Eastern European countries shows, for example, that banks are playing an increasingly important role and that very close links are developing between the banking and the industrial sectors. Banks possess the key to improve corporate governance in Burundi and in most of the developing countries; they shall make the adoption of a

strong and an enforceable code of corporate governance, together with a strong code of ethics, a condition for financial support to financial institutions.

## **ANNEXURE**

### **I. QUESTIONNAIRE**

1. What is the Bank's policy regarding lending to companies?
2. What types of loans does the Bank offer to companies?
3. How do you determine which company to lend money to? (Lending criteria)
4. How do you monitor companies that you lend money to?
5. On which institutions do you rely to enforce your obligations?
6. Do you think the monitoring mechanisms you employ have a long term impact on the management of the companies?
7. What obligations does your Bank impose on the company when it borrows?
8. How does your Bank ensure that the company complies with the obligations imposed?
9. How does the Bank respond when the company defaults or is late on repayment?
10. What are the provisions in the credit agreement between the Bank and the borrower company?

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