TITLE: INCORPORATION: A CRITICAL ANALYSIS OF WHETHER IT IS A REMEDY OR A MISCHIEF.

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DATE/YEAR: 2012

An Obligatory Essay submitted to the school of Law of the University of Zambia in partial Fulfilment of the requirements for the award of the Degree of Bachelor of Laws (LLB).

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DECLARATION

I, **KAPIANGA, KELLY** of computer number **28095634**, do hereby declare that the contents of this Dissertation are entirely based on my own findings and that I have not in any respect used any person's work without acknowledging the same to be so.

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ABSTRACT

Pursuant to the claim that by the international community that economic stagnation in Zambia can be attributed to its poor economic institutions, the research shows that Zambia has some good institutions using the limited company as a case study. To adequately evaluate the value of companies as economic institutions, the research gives a historical discussion of the various business associations that emerged with special focus on ancient Rome, Medieval Arabia, medieval Europe and Britain, highlighting the forces that were at work in fashioning the business enterprises in these societies.

The research goes further to discuss the value of entrepreneurship, which is sought to be established by good economic institutions; to encouraging economic development. It further highlights the various features that have emerged in history to facilitate entrepreneurial activity and discusses whether these are present in the limited company as known in Zambia. The research then proceeds to show how, using some of the identified features, the limited company has been used in Zambia’s history to encourage economic development.

The research highlights that in truth, the limited company is a good institution and does possess features that can encourage entrepreneurship and that the reason the limited company has not been very effective in facilitating entrepreneurial activity in Zambia is not because it is inherently defective. However, this notwithstanding, the research goes on to recommend ways of improving the limited company in Zambia such as updating Companies legislation by introducing codes of good corporate governance as well as introducing more to aid companies in financial distress to regain their profitability.
ACKNOWLEDGEMENTS

I would like to extend my gratitude to My Lord, the creator of all things for the protection, love, good health and blessings not only to myself, but my parents and siblings, my friends and my classmates. I would also like to thank God for the strength and wisdom in undertaking this and many other tasks I have been able to accomplish.

I would also like to greatly thank my supervisor, DR. Iris Mwanza, who has virtually walked me through this research from scratch, tirelessly correcting my mistakes at every stage and urging me on. I was privileged and I am honoured in particular for letting me share into the wealth of her wisdom and for that I am eternally grateful.

This research has also benefited from careful and thoughtful editing by a number of people. In particular, I want to acknowledge the excellent help from my friends Zhunga ‘Pope’ Simbwalanga, , Mr. Raphael ‘Captain’ Chilala, Niphegie Choonga ‘Pilingana’ Simulyamana, Favour Mandanji Nyikosa, Joshua Kabwe, Joshua Mwamulima, Mahape Libakeni, Arnold Kaluba, Gloria Muyunda, John Ngisi, Roy Mwala, Emmanuel Phiri, Nasilele Simasiku and all that have been involved either directly or circuitously in the completion of this research whose names I have omitted. Thanks, friends!

To my family members, my father Mr. Kelly Kapianga, and my mother Mrs. Mercy M. Kapianga and my siblings, I say thank you for the love, support, the prayers and most importantly the money. I only hope that I can pay it back through my deeds and that I can be there for you when you need me.
DEDICATION

To my parents Mr. And Mrs. Kapianga and my younger brothers Kamungala and Nyanga Kashembe Kapianga and my sisters; thank you for believing in me. Dad, I am as good as you always said I would be when I grow up and mum, thank you for believing in me when I needed you the most. Thank you for showing me the way. Brothers, I wish I have sufficiently challenged you. I hope, through my achievements and my behaviour, I have discharged my duty of setting a good example for you.
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Chapter 1: General Introduction

1.0. INTRODUCTION

A number of ways have been suggested as means through which poor countries can improve their economic performance, the most popular being the adoption of the capitalist economic model involving the removal of the restraints to foreign trade, economic liberalisation, and privatisation of state owned enterprises. The most recent proposal has been that poor countries should undertake institutional reforms and this is particularly emphasised by the World Bank and International Monetary Fund (IMF) through their Structural Adjustment Programmes (SAPs) that attach to their loans. Since the 1980’s the view that deficient institutions in poor countries are the root-cause of economic problems has become widespread among the members of the donor community. Once a marginal topic, the role of institutions in economic development has become one of the most popular areas of research over the last ten to fifteen years,\(^1\) with the World Bank and IMF emphasising that development can only be attained if poor countries adopt ‘better institutions.’ These ‘better institutions’ are generally understood to be those institutions typically found in the United Kingdom and America.\(^2\)

Companies are institutions. Little defines an institution as “a specific ensemble of interlocked organizations and laws and rules that serve to coordinate and constrain the behaviour of a number of individuals.”\(^3\) Institutions are often refined to bring about specific effects in society depending on the needs of the societies in which they emerge. In this respect, the reformers of social institutions are the players and stakeholders who have the capacity to change specific aspects of the institution. Because institutions are borne out of social demand, they are

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normally society-specific and are created to serve a particular purpose and ‘function’ and this determines the nature and form they assume, and ultimately sets them apart from institutions in other societies.⁴

Whilst institutions are fashioned by a society’s culture and ways of life, they also affect how people behave. In relation to business organisations, it is contended that once a society has adopted efficient institutions, that is, institutions that assure citizens of a good return on their investments with acceptable risks; entrepreneurship would be encouraged. Entrepreneurship can simply be defined as the creation of new business by taking advantage of opportunities that emerge in society. In this manner, good business associations as institutions are seen as providing a ready-made framework for entrepreneurial activity to emerge and flourish in society. Zambia is among the many societies that have attempted to fashion a business organisation to encourage entrepreneurial activity. Business associations involving individuals who pool their resources and act in concert can be traced as far back as the 10th Century BC to ancient Rome⁵, and other enterprises can be traced to the Arabic world, medieval Europe and Britain. The emergence and transformation of the forms of business organisations reflected the prevailing demands of businessmen in those societies as well as political, economic and social forces of their times.

That entrepreneurship can lead to economic development is now beyond debate. However, exactly how it leads to development has attracted as many positions as they are schools of thought on who an entrepreneur is. One school of thought, headed by Joseph A. Schumpeter, views entrepreneurs as special people who are endowed with innovative skills. These individuals use their innovation to outcompete their competitors in an economy and these

⁴ Daniel Little, “Institutional Change”.
competitors are in turn forced to be innovative to survive. This competition in innovation therefore leads to increased productivity in society as better technologies and means of production are introduced by competing businesses in a firm to try to beat their counterparts.\textsuperscript{6} Other scholars view entrepreneurs as ordinary individuals who merely create new businesses. This leads to development since the new businesses will mean new incomes and taxes to the government which increases liquidity in the country that can be used to finance other development oriented programs in society.

In this respect, it becomes important that appropriate institutions are created to encourage entrepreneurship, but important still is the need to ensure that an environment for the proper operation of these institutions is secured in a country.

1.1. STATEMENT OF THE PROBLEM

For so long Zambia has been asked to change its institutions as a means of attaining economic development. The Structural Adjustment Programs were based on the thinking that Zambia’s economic stagnation was borne out of its poor institutions. It is argued that the institutional framework, particularly the business enterprises are not suitable to encouraging entrepreneurship as the role of entrepreneurship is often credited with many positive changes in developing countries. The problem to be addressed is determining whether Zambia’s economic stagnation is as a consequence of having poor institutions, using the limited company as a case study.

1.2 PURPOSE OF THE STUDY

The study seeks to pave the way to the view that fostering economic development goes beyond the creation of good institutions. For so long, the economic stagnation in developing

countries has been attributed to poor institutions; this research will show, that as far as business associations are concerned, Zambia has good institutions in companies and the problem may lie in the regulatory environment which frustrates the operation of these institutions.

1.3 SIGNIFICANCE OF THE RESEARCH

It is time that indigenous Zambians realise that the country will never develop unless and until a culture of entrepreneurship is imbedded into the mind of every Zambian. Zambians need to take matters of development into their own hands. Undeniably, the law is the best instrument to usher in this new era. This is because the economic environment affects the willingness and ability of potential entrepreneurs to invest. The poor condition of the Zambian economy is itself a manifestation of the dire need for Zambians’ attitude towards entrepreneurship to change. This change can be properly ushered in if the law paves the way and creates incentives for people to invest. This would entail repealing and replacing archaic legislation, and amending the laws regulating business organizations to suit prevailing conditions. The research thus seeks look at the corporate form in depth and discuss whether it can foster an entrepreneurial spirit in the people and recommend ways in which it can be improved.

1.4 OBJECTIVES OF THE RESEARCH

The research, seeks ultimately to show that the limited company is a good institution which can be used to encourage entrepreneurship in Zambia. To achieve this objective, the research seeks to show:

(i) That institutions are social creatures which are moulded by society. Likewise, since business organisations are institutions, they are also moulded by these social forces and seek to address specific questions. As such the research will give a detailed account of the emergence of business associations in Ancient Rome, the Arabic
World, medieval Europe and Britain to show the effect of social forces on the business organisation. The hypothesis which is sought to be proved is that a good institution is one designed to appropriately address and does in fact address a social demand.

(ii) That entrepreneurship, which is the goal towards which good business associations are being moulded to achieve, does indeed lead to economic development.

(iii) That despite the limited company not been a creature of Zambian culture, it possesses certain features which can benefit Zambian businesses and can thereby instil entrepreneurship.

(iv) That the limited company has been used in the past under the Kaunda regime and the Chiluba regime to foster economic development in response to the economic forces prevalent at the time.

1.5 DEFINITION OF OPERATIONAL TERMS

Shares: the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se.

Floating Charge: a charge which floats like a cloud over the assets from time to time falling within a generic description, but without preventing the mortgagor from disposing of those assets in the usual course of business until something occurs to cause the charge to become crystallized and fixed.  

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7 Per Farwell J in Borland's Trustee v Steel Brothers [1901] 1 Ch 279.
Institution: A specific ensemble of interlocked organizations and laws and rules that serve to coordinate and constrain the behaviour of a number of individuals.9

Entrepreneurship: The ability to identify, pursue and exploit the value from a business opportunity.10

Limited Liability: The limiting of the liability of a member of a company to the value that remains unpaid on his shares in the case of companies limited by shares and to the value that he undertook in the declaration of guarantee in case of a company limited by guarantee.11

1.6 METHODOLOGY

This research is a desk research. Descriptive research will be used because the data which is qualitative in nature as derived from books, journals and articles will be utilized.

1.7 OUTLINE OF CHAPTERS

This research is divided into five chapters as follows

Chapter 1 introduces the research topic. It gives an overview of the study in broad strokes and also discusses the general introduction, the statement of the problem, the purpose of the research, its significance and objectives.

Chapter 2 discusses how social forces mould business entities using the history of business organisations in ancient Rome, the Arabic world, medieval Europe and Britain as examples.

Chapter 3 shows the link between entrepreneurship, which the adoption of good business entities seeks to establish and economic development. It does so by exploring two philosophical view points, that is, the philosophers that see entrepreneurs as being special kinds of people and those that merely see them as ordinary people that create businesses.

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9Daniel Little, “Institutional Change.”
11Section 17 (3) and section 19 (6) of the Companies Act.
Chapter 4 discussed whether the limited company is a good institution by considering whether its components are of value to encouraging entrepreneurship. It also shows how the corporate form has been used to Zambia’s benefit in the past.

Chapter 5 provides a conclusion to the research and lays down the recommendations proposed by the research.

1.9 Conclusion

This chapter has discussed what the research seeks to do. It has laid down the foundation on which the rest of the research will build and showed the problem to be addressed, the purpose of the research, its significance and objectives; the methodology employed and it has also defined the phrases which are going to be used in the research. It has also outlined what each chapter seeks to do in resolving the problem indicated and the basis on which the recommendations will be made.
Chapter 2: A Historical Analysis of the Societal Factors Affecting the Emergence of Multi-
Owner Business Associations

2.1 Introduction

The previous chapter underscored various attributes that underlie social institutions which
include: ‘plasticity’, that is, institutions are adjusted and shaped by social players; ‘path-
dependence’ that is, the particular features of the institution today are the result forces in a prior
generation; ‘heterogeneity’ that is, institutions should be expected to proliferate and differentiate
over time; and ‘agent-centred explanations’, that is, institutions take shape through the deliberate
actions of the agents who populate them.\(^1\) Therefore, the institutions of a society are the result of an
evolution depending on the purposes and functions as dictated by society’s needs and demands over
time. Thus we need to look to history to understand the value and propriety of the institutions
because as North puts it:

“History matters. It matters not just because we can learn from the past, but because the present
and the future are connected to the past by the continuity of a society’s institutions. Today’s and
tomorrow’s choices are shaped by the past. And the past can only be made intelligible as a story
of institutional evolution.”\(^2\)

The question the chapter seeks to answer is: What determines the nature of institutions that
emerge in a given society? The hypothesis it seeks to prove is that institutions emerge because of,
and are fashioned by the prevailing social conditions.

Business organizations are a product of evolution. Accordingly, Dr. Talbot argues that the law
of business organizations is shaped by three main factors: economics, ideology [and culture]; and

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\(^2\) Douglas North, *Institutions, Institutional Changes and Economic Performance* (New York: Cambridge University
existing law.\(^3\) The history of the various forms of business associations is a manifestation of the inter-play between these factors. Thus, an analysis of the entities that emerged from as far back as ancient Rome through to the English Limited company reflects the role that societal factors have in shaping business organisations.

2.2. Forms of Business Organisations In History

2.2.1 Business Organisations in Ancient Rome

The factors that moulded the business organisations in Rome stemmed from Roman politics, economics, law and culture. Politically, between the third and first century BC, Rome was growing from a rural community to a superpower. The expansion of the Empire facilitated the emergence of large-scale commerce, leading to the development of industries and a vibrant financial sector; causing trade especially seaborne trade to expand. To add on, Roman law facilitated commerce because of its flexibility.\(^4\) Under Roman law and culture the basic legal unit was the family represented by its male head (usually the father). The father exercised total dominion over his children and the slaves and this was referred to as *Patria Potestas* (power of a father).\(^5\) This power meant that he had control over his children and slaves and that he alone had any rights in private law and could thereby contract with third parties.

Arising from these factors, the earliest business entity to emerge was the *negotiatio per servos communes* which was a direct consequence of the *Patria potestas* custom. This was created by the father allocating a portion of the family assets (called ‘peculium’) as a separate business enterprise to be run and managed by the son or slave, with the father retaining legal ownership of the

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\(^3\) Dr Lorraine E. Talbot, *Critical Company Law* (Oxon: Routledge-Cavendish Publishing Company, 2008), p i

\(^4\) Ulrike Malmower, "Law and Finance at the Origin", p.8 visited 26th January 2012 ulrike@econ.berkeley.edu

apportioned property. ⁶ Since the slave or son was not a person at law, all contracts he entered into with third parties bound the father within the limits of the peculium. Thus under this enterprise, if the business incurred debts the creditors could sue the father, although his liability did not extend beyond the amount in the peculium and any profits. In this way, the negotiatio per servos communes was the first entity to adopt a measure of limited liability.

Later, however, another entity called societas (meaning ‘partnership’) emerged owing to the need to engage in foreign trade. The societas developed from the ancient custom called erceto non cito (partnership by undivided inheritance) among heirs who decided to administer their inheritance jointly rather than distributing it amongst themselves. ⁷ This entity was an agreement between people to start an enterprise and share its profits and losses, under which, since there was no legal difference between the ‘partners’ (socius) and the business; they could be personally sued for the debts of the business. However, each partner was only liable in proportion to his contribution in the enterprise (on a pro rata basis).⁸

With the expansion of trade beyond the boundaries of the Roman empire, the Societas Publicanorum, emerged around the 3rd and 4th century B.C to encourage more investors to pool their resources into a joint business venture. ⁹ This entity was a multi-owner enterprise consisting of investors called publicani who pooled their resources into a common stock. This entity had perpetual existence, according to which the death of a member (‘publicani’) would not dissolve the entity. Secondly, an appointed official could represent the entity and was called ‘Manceps.’ Finally, the entity had shares (‘Partes’) which were tradable therefore; shareholders ‘Participes’ could transfer their shares to third parties. This entity resembles in many respects, the modern companies.

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⁷ Ulrike Malmendier, “Societas”,
⁹ Ulrike Malmendier, “Societas”.
2.2.2 Business Organisations in the Arabic World

The forms of business organizations that emerged in the Arabic world were informed by the Shari’a law which embodies the Islamic religious and state law; as well as Arabic culture and tradition. Ahmad sums up the forces that fashioned the forms of business entities that emerged in the Arabic world when he says: “Islam is the only major world religion founded by a businessman.” Consequently, from its inception, Islam has always been favourable for commerce and this favour is expressed in a number of ways. Firstly, under Shari’a law individual property is strongly protected and hard work is encouraged. Furthermore, Islam establishes a code of ethics in business transactions which prohibit usury, fraud, theft and any other injustice. However, Islam’s provision that all men are the Khalifah inhibited the emergence of corporate forms because legal standing was limited only to natural persons.

Economically, the destruction of the Roman empire, made the Arabic world the centre of commerce in the world and this was supplemented by the Arabic Agriculture revolution which led to the region becoming very wealthy around the 8th to 13th century. From these forces, the first entity to emerge was the Qirad. The Qirad was a contractual agreement between two parties usually members of the same clan, one providing the capital and the other the labour, for a mutual venture and the risk of loss was borne by the financier, who also took the greatest share of the profits. With the expansion of the scope covered by the Arabic merchants, the Qirad was later modified and refined to become a Mufawada, involving trade between clans and the equivalent of a general partnership; and the Mudaraba, equivalent to the limited partnership; both of which involved

11 Imad-ad-Dean Ahmad, “Islam, Commerce, and Business Ethics,” p.3.
12 Translated as ‘earthly teacher of men’.
14 Bruce Brown, The History of the Corporation.
multiple investors. The transition from the Qirad to the Mudaraba was a response to the gradual increase in the scope and volume of trade facilitated.

2.2.3 Business Organisations in Medieval Europe

Like in the other societies, the forms of business entities that emerged reflected the prevailing conditions in medieval Europe especially Italian law, culture, and economic affairs. Under Italian law, the family was the basic legal unit. Consequently, the first form of business association to emerge was the Compagnia. The Compagnia was essentially a partnership between family members. It differed from the Roman Societas not only in its use of the rule of joint and several liability and not pro rata among partners to the firm’s debt but also because the Compagnia imparted mutual agency among the partners which meant that every partner could bind the others to a contract in the ordinary course of business.

Next to emerge was the Commenda which was a response of the need for a business enterprise to allow an accumulation of capital to finance bigger ventures in foreign trade. The commenda had at least two members some of which contributed the enterprise’s capital whilst the other (a travelling trader, usually a ship’s captain) contributed labour and initiative. The partner(s) who contributed the capital never took part in the management of the enterprise and consequently was not personally liable for the liabilities incurred by the entity. To meet the capital requirements, the passive partner(s)’s position was divisible, that is, the passive partner could, in consultation with the active partner allow other investors to contribute to the enterprise’s capital.

2.2.4 Business organizations in Britain

The factors that fashioned the business entities in England can be linked to the Industrial Revolution. The industrial revolution which involved mass produced goods led to an expansion in commerce in Britain, which led to the need for an enlarged market and source of raw materials to

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feed the factories; which in turn led to imperialism.\textsuperscript{16} Geographically, Britain, with its unlimited access to the ocean capitalised on this development by importing raw materials from far flung areas around the globe like India, and latter from colonies; and exported in return, finished products. Additionally, trade within Britain was enhanced by the facilitative common law with its principle of ‘freedom of contract’ which left merchants free to trade in whatever manner and on whatever terms they saw fit. Financially, the establishment of the Bank of England in 1694 and informal credit institutions provided a steady stream of finance for the furtherance of commerce.

Around the sixteenth century, the principal business associations in Britain were the Guilds of Merchants\textsuperscript{17} where individual merchants were free to trade on an individual basis, subject only to the rules of the guild as to such things as quality standards.\textsuperscript{18} Another business enterprise was the ‘general partnership’\textsuperscript{19}, which arose due to the influence of the Italian merchants.\textsuperscript{20} This enterprise involved at least two merchants who traded on a joint account from a joint stock and the rules regulating this form of business enterprise were later codified into the Partnership Act of 1890.\textsuperscript{21}

To encourage the creation of large business associations in the commercial sphere, the Crown (and after 1688 also parliament by a special Act) granted Royal charters around the 14\textsuperscript{th} Century under which associations of people would be granted special privileges such as monopoly trading rights, limited liability etc. as they undertook the trading ventures.\textsuperscript{22} These charters were originally granted to guilds of merchants engaged in overseas trade and they became known as

\textsuperscript{17} G.L.C.B Gower, Gower’s Principles of Modern Company Law, p. 22
\textsuperscript{18} G.L.C.B Gower, Gower’s Principles of Modern Company Law, p. 22
\textsuperscript{19} Called ‘societas.’
\textsuperscript{21} The English Partnership Act, 1890.
\textsuperscript{22} L.B.C Gower, Gower’s Principles of Modern Company Law, p. 24
‘Regulated Companies’. The members of the enterprise essentially traded on an individual basis but the early 17th Century trading on a joint account with a joint stock was adopted. These new enterprises became known as ‘Joint stock Companies’.

Due to the fact that the Crown granted charters sparingly, by the end of the seventeenth century people devised a way of enjoying the benefits of incorporation without a charter and thus the ‘Deed of Settlement Company’ emerged. The entity was constituted by grafting the trust form onto the partnership, whereby ‘partners’ pooled their stock to form a common stock, but in order to add a measure of limited liability, the stock thus pooled was placed in trust for the partners and vested in trustees.

Finally after intense social pressure, in 1844 Parliament enacted the ‘Joint Stock Companies Act’ which permitted incorporation as a matter of right and not upon being granted a charter by the Crown or a special Act of Parliament. This Act, however, did not confer limited liability on these entities until 1855 when the Limited Liability Act was enacted. Subsequent amendments were made to the Act, including the Companies Act 1907 which distinguished public from private companies and subjected the former to stricter rules and higher disclosure requirements than the latter.

The concept of limited liability was extended to the partnership, firstly in 1907 with the enactment of the Limited Partnership Act, under which at least one partner has unlimited liability and others enjoy limited liability provided they do not take active part in the venture; and later the Limited Liability Act of 2006, which essentially enables the creation of partnerships as separate legal entities with all partners enjoying limited liability.

2.3 Conclusion

23 L.B.C Gower, Gower’s Principles of Modern Company Law, p. 24
In conclusion, the research has shown that since business entities are also social institutions, they emerge from the prevailing conditions in society. The form they take, and the attributes they embody are designed to meet specific functions as society demands. For example, the Societas Publicanorum in ancient Rome could freely trade its shares so that people could be encouraged to invest in the enterprise and thus benefit Roman society by building public infrastructure. Accordingly, separate legal personality and limited liability emerged in England at the height of the industrial revolution to provide investors with an incentive to undertake the risks involved in overseas trade. An even better example is how Islam’s view that persons should be held accountable for their deeds prevented the corporate form from emerging there. From this, the it can be concluded that indeed business organisations, like any other institutions are fashioned by certain forces in the society and how efficient they are therefore depends on how best they respond to the society which they operate. The hypothesis has thus been proved.
Chapter 3: Is there a link between entrepreneurship and economic development?

3.1. Introduction

The previous chapter highlighted the important part that a nation’s history plays in moulding its institutions. The present chapter seeks to determine whether there is a link between entrepreneurship, which is sought to be established by the introduction of suitable business institutions, and economic development. The chapter will begin with a brief discussion of the emergence of the view that entrepreneurship is a mode of fostering economic growth. It will proceed to discuss what entrepreneurship is, whether or not it can lead to economic development, and critically examine the propositions raised thereunder. The chapter will conclude with a summary of the findings of the research. The hypothesis this chapter seeks to prove is that there is a definite and concrete link between entrepreneurship and economic development.

3.2. Entrepreneurship and Economic Development

Sustainable economic development is not an easy thing to attain. Attempts have been made to develop the country, ranging from a centralized economy under the Kaunda regime where the state supervised all economic activities, to the present liberalised economy where economic activity is left to the individual citizens; yet development seems to still elude the country. The logical question is “why?” The World Bank development report states that society’s ability to enhance well-being through time depends on the choices made by individuals, firms and communities on how to transform their assets.¹ In a similar vein, Baron Bramwell echoes the need for private participation in the economy when he opined that:

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"If ever there was a rule established by reason, authority and experience, it is that the interest of a community is best consulted by leaving it to its members, as far, as possible, the unrestricted and unfettered exercise of their own talents and industry."  

The answer, therefore, seems to be that Zambia has failed to develop because she has never truly let the citizens run the economy. When development is citizen-led, not only is it better sustained because it is obviously ‘immune’ to vices such as corruption, nepotism, bureaucratic inefficiency, and other deficiencies in governance; but the wealth created is also able to trickle down to the grassroots in society more effectively because of the bottom up effect that entrepreneurship has on a society’s development. Thus, in developing countries like Zambia where transparent and accountable governance is yet to be achieved, this would be ideal.

In a country like Zambia, efficient institutions and accountable governance are yet to be attained: For example, a World Bank survey in 2004 revealed that business enterprises in Zambia have to pay an average of 1.7 percent of their total revenue in bribes, and that an average of 3.7 percent of the value of any government contract has to be paid to government officials ‘to get things done!’ ² Worse still, in the same year Transparency International ranked Zambia 118th out of 155 countries in terms of corruption. ³ In 2007, about 15 percent of the businesses were expected to make informal payments to public officials to get things done while 27.5 percent were expected to make gifts to secure government contracts, ⁴ and in more recently, in 2008 the Index of Economic Freedom confirms Zambia’s poor performance in the fight against

This therefore shows a chronic failure on the part of the government in stimulating enterprise to facilitate the emergence of private business.

It is proposed that adopting a good business institution would encourage entrepreneurship as it would provide a ready-made framework which the citizens can utilise in their business activities and the better the framework the more encouraged the citizens will be. The encouragement of private enterprise is key to achieving economic development. If there is any truth to this argument, then a definite link ought to be shown between entrepreneurship and development.

3.3 The Link between Entrepreneurship, Investment and Development

3.3.1 Who is an entrepreneur?

The term ‘entrepreneurship’ has been defined differently by different scholars leading to two positions as to what the entrepreneur’s role in development is. To some, an entrepreneur is a special person endowed with innovative skills and creativity which distinguishes him from the rest of society. To these theorists “entrepreneurship rigorously defined, refers to the creation of a new economic entity centered on a novel product or service or, at the very least, on which differs significantly from products or services offered elsewhere in the market.”\(^\text{10}\) To others, an entrepreneur is any ordinary person who merely creates and runs an enterprise. In this respect, they define an entrepreneur as “an individual whose primary occupation is to run a business (working alone or employing others) and who is engaged in this occupation looking forward to

corruption, with a score of 26 percent in terms of freedom from corruption. These statistics show that the state is not the best entity to allocate wealth and, if ever sustainable development is to be attained, it will have to be initiated and driven by the citizens themselves.

To facilitate the emergence of private enterprise, government is obliged to not only provide an enabling regulatory environment for the flourishing of private investments, but it should also promote economic activities among the citizens. In support of the above proposition, economists claim that there is a definite link between economic growth and prosperity, investment and the business climate. They argue that the private sector is the key to attaining sustainable development and therefore, the role of the government through the law should be to facilitate the emergence of a potent private-sector-driven economy by creating incentives for private entrepreneurship and investment.

This component of government promotion of private enterprise is exactly what is missing in the Zambian economy. The Zambian government has, since 1991 liberalised the economy and has in fact created an economy open for private economic activity; but as indicated above, more needs to be done. A good investment climate must encourage, promote, stimulate and in fact ‘entice’ economic activity as well as instill an entrepreneurial spirit in the people. Thus according to the World Bank, eighty-two percent of the businesses covered in its survey stated that the biggest constraint on investment in Zambia is capital constraints. It was discovered that businesses have to pay an average of twenty-eight percent interest per annum on bank loans and that the collateral required securing the loans was on average, three times the value of the loan.

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8 World Bank, "An Assessment of the Investment Climate in Zambia."

grow or at least to sustain this business in time."\textsuperscript{11} Similarly, the link between entrepreneurship and economic development has followed this differentiation.

\textbf{3.3.2 Entrepreneurs as Innovators}

One of the proponents of the view that an entrepreneur is a special person is Joseph A. Schumpeter in his theory of \textit{Creative Destruction}\textsuperscript{12}. To Schumpeter, the principle role an entrepreneur plays in fostering economic development is through his innovation. He argues that the entrepreneur finds ways of going about the management of his business in an innovative and creative manner, which distinguishes the entrepreneur from other traders. To Schumpeter:

"To undertake such things [innovative things] is difficult and constitutes a distinct economic function, first, because they lie outside the routine tasks which everybody understands and secondly because the environment resists in many ways that vary, according to social conditions, from simple refusal either to finance or to buy a new thing, to physical attack on the man who tries to produce it."\textsuperscript{13}

Thus the entrepreneur is innovative because he is able to exploit opportunities for creating profitable competitive positions that other firms either ignore or cannot exploit.\textsuperscript{14} He is thus able to out-compete the other businesses in the industry, ushering in a period of calm in which the entrepreneur's enterprise, possessing superior products, technologies, and/or organizational capabilities; earns positive economic profits and enjoys sustainable growth due to its competitive position. The threat of market entry by more innovative entities keeps the entrepreneur disciplined and competitive, ensuring that he invests his profits in new ideas and


\textsuperscript{13} Joseph A. Schumpeter, \textit{Theory of Economic Development}, p. 42.

\textsuperscript{14} Paul Klimek, "Empirical Confirmation of Creative Destruction from World Trade data," \texttt{Center for International Development} (December 13, 2011): 2.
products thereby increasing overall productivity (defined as the value added per firm).\textsuperscript{15} In time however, the other players in the economy would be compelled to be innovative, by introducing new and better ideas and technologies to outcompete the entrepreneur and destroy his competitive advantage, thus leading to collapse in the monopoly of the entrepreneur’s business. This process would continue to repeat itself in a vicious cycle until the entire economy is innovative, leading to increased productivity and output thus improving a society’s economic performance.

However, one objection to creative destruction as leading to economic development is that, since business enterprises have to be \textit{destroyed} for others to be \textit{created} no progress will in truth have been made as the new enterprises will merely be \textit{replacing} the old. And further, since there is no real increase in firm numbers, there is no real job creation. A response to these objections is that since the new enterprises will introduce more complex means of doing business and superior products resulting from their innovation, it will be able to employ \textit{more} employees on better conditions of service than the former entities owing to the profits it will be able to realise as a consequence of its competitive advantage. Additionally, the new enterprises instill a sense of competitiveness in that innovation and creativity are made the criteria for the sustenance of the firm.

Empirical support to this proposition is in a research conducted by Davis et al\textsuperscript{16} in their study of creative destruction in the US manufacturing industry. The research conclusively shows the presence of creative destruction in that over ten per cent of the jobs that existed at any one point in the industry were found either not to have existed the year before, or not to exist a year

\textsuperscript{15} Pierre Cahuc, \textit{“Lecture on Master Economics and Public Policy: Schumpeterian Growth.”} (Winter 2011): 3 Accessed on 9\textsuperscript{th} February 2012, \url{Http/sites.google.com/site/cc553x}.

\textsuperscript{16} Cited from Ricardo Caballero and Mohammad I. Hammour, \textit{“Creative Destruction in Development: Institutions, Crises and Restructuring”}, p. 7.
later and that this accounted for over fifty per cent of the overall increase in the productivity of the new firms. Thus, the businesses replacing the old ones brought more jobs than the old entities had sustained. Cahuc confirms this position in a global research and presents his findings as indicated in figure 1.

**Figure 1**

<table>
<thead>
<tr>
<th>Country</th>
<th>Time Period</th>
<th>Job Creation</th>
<th>Job Destruction</th>
<th>NET Employment Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>1984-1991</td>
<td>12.7</td>
<td>11.8</td>
<td>0.9</td>
</tr>
<tr>
<td>Germany</td>
<td>1983-1990</td>
<td>9.0</td>
<td>7.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1984-1991</td>
<td>8.2</td>
<td>7.2</td>
<td>1.0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1985-1991</td>
<td>8.7</td>
<td>6.6</td>
<td>2.1</td>
</tr>
<tr>
<td>United States</td>
<td>1984-1991</td>
<td>13.0</td>
<td>10.4</td>
<td>2.6</td>
</tr>
</tbody>
</table>

*In millions* Source OECD

As indicated in the table, there is a net increase in the number of jobs created with the replacement of old enterprises by new ones.

Another objection to creative destruction as fostering development lies in the fact that it is not always possible for new enterprises to displace incumbent firms. This is because incumbent firms have the advantage of experience and established connections. Dore supports this argument when he submits that incumbent enterprises have certain advantages that might help them mitigate the competitive pressures from the new entrants such as goodwill due to having an already established presence as well as a loyal customer base; well established

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17 Richard Caballero and Muhammad I. Hammour, “Creative Destruction in Development: Institutions, Crises and Restructuring”, p.3.
distribution networks, as well as better access to finance both internally, from reserves of past profits and externally due to previous dealings with financial institutions.\textsuperscript{21}

The objection given by Dore is too powerful to be ignored but his ideas can be accommodated into the theory of Creative Destruction. Although innovation may not always allow new firms to outcompete incumbent ones, where incumbent firms are not ousted, competition forces them to become innovative and creative themselves to stay aloft. In any event, this instills competition, increases productivity and output, creates jobs, and gradually and steadily results in economic development. All in all, creative destruction does foster economic development.

3.3.3 Entrepreneurs as creators of businesses

To other theorists, the entrepreneur is an ordinary person who starts a business: thus the hallmark of an entrepreneur is not necessarily any creativity or innovation he might possess over others, but merely the fact that he creates and runs a business enterprise. In this paradigm, the entrepreneur fosters economic development by creating new businesses; entrepreneurs create employment for at least themselves and sometimes others. More importantly entrepreneurs initiate a chain reaction which finally leads to economic development.

Entrepreneurship creates businesses which create employment, which in turn generate wages and demand for existing businesses which allows them to expand. The taxes lead to an increase of the government's revenue pool, whereas the wages if banked lead to liquidity in the capital market which can be a source of capital for other businesses. In addition, the demand created by the new wages leads to the expansion of existing enterprises which allows them to

\textsuperscript{21}Timothy Dore, "Creative Destruction and an evaluation of the incumbents" p.2.
employ more employers allowing the process to be repeated. Goldberg\textsuperscript{22} more comprehensively expresses this chain reaction as shown in figure 2.

\textbf{Figure 2}


The increase in the number of businesses in the economy creates competition which in turn forces these businesses to be efficient to have an economic edge over the competitors and thereby increase their productivity (that is, output per firm in the economy).

\textsuperscript{22} Martin: Goldberg, \textit{International Interdependence-Evolution of Global Trade}, (New York: Maltigrove CI 2007) p. 2
In this regard, Lueh opines that China’s entrepreneurs have been the primary drivers of the boom that has been characteristic of the Chinese economy for the past thirty years.\(^\text{23}\) The boom in the Chinese economy is attributed to the economic reforms introduced in 1978 by the then Chinese leader Deng Xiaoping, whose major idea was to introduce individual as opposed to communal ownership of property and thereby encourage entrepreneurship. To add on, Xiaoping encouraged entrepreneurship by stimulating the formation of rural enterprises and private businesses, liberalising foreign trade and investment, relaxing state control over some prices, and investment in industrial production and the education of the Chinese workforce.\(^\text{24}\) This led to the emergence of private enterprises primarily the rural industries, township and village enterprises which, by the 1990s accounted for nearly a third of the GDP.\(^\text{25}\)

The primary effect that the reforms had was to encourage the participation of the citizens in the Chinese economic development and this led to increased productivity. According to the International Monetary Fund (IMF), the importance of the private sector in China’s economic growth has been the instillation of productivity (i.e. the value added per worker) in local enterprises as a consequence of the competition that is fostered by 1978 economic reforms and liberalisation.\(^\text{26}\) Following from these reforms, the productivity in Chinese firms increased from 1.1 per cent between 1953 and 1978 to 3.9 per cent between 1978 and 1994 (compared to the US’s rate of 0.4 per cent between 1960 and 1989). This increase in productivity led to an unprecedented economic growth rate of between 9 and 13 per cent between 1978 and 2011 and incomes to quadruple since 1978.\(^\text{27}\)


\(^{24}\) Zuliu Hu and Moshin S. Khan, “Why is China growing so fast?” (Accessed on 16\(^{\text{th}}\) March 2012) www.imf.org

\(^{25}\) Linda Yueh, “China’s Entrepreneurs,” p. 15.

\(^{26}\) Cited in Zuliu Hu and Moshin S. Khan, ‘Why is China growing so fast?’

\(^{27}\) Zuliu Hu and Moshin S. Khan, “Why is China growing so fast?”
3.4. Conclusion

From the forgoing, it has been shown that the need for citizen involvement in a country’s economic activity as a means of fostering economic activity arises as a way of trying to circumvent the bureaucratic inadequacies that plague developing countries like Zambia. It therefore becomes very important that the government should create a favourable climate for the emergence of investment. This entails not only liberalizing the economy but also taking positive steps to encourage, facilitate and promote entrepreneurial activity in the economy. This is because, as argued by Schumpeter, the competition created by entrepreneurs in the economy leads to an economic ‘survival of the fittest’ environment. The mode of survival adopted by the firms becomes innovation and creativity which, not only benefits the citizens in terms of quality and low prices, but also increases general economic output and productivity. Additionally, entrepreneurship creates employment which, as explained above, ultimately leads to economic development. It has therefore been established that there is a strong link between entrepreneurship and economic development.
Chapter 4: Is the Limited Company the best form of business association?

4.0 Introduction

This chapter seeks to determine whether the limited liability company is the best form of business enterprise available, thereby necessitating its adoption in a country like Zambia as a way of encouraging entrepreneurship to stimulate development. It also seeks to show how the limited company has contributed to Zambia’s economic growth in the past.

Throughout history, a number of business associations took root in various nations as indicated in the chapter 2, and with them came various features each emerging to address a particular mischief in the particular economy at a given time. Some of these features emerged across cultures, reflecting the homogeneity of the problems faced by entrepreneurs the world over.

4.1 Important Features that Emerged in Business Associations in History

4.1.1 Multiple Membership of the Business Enterprise

Multiple-membership as a feature of business enterprises emerged in ancient Rome, and the medieval Arabic world, in medieval Italy and Britain.¹ Thought of simply, it seems more profitable for individuals to carry on business alone, instead of joining associations. This is because not only do they enjoy greater flexibility in decision making, they also keep all the profits of the enterprise. However, most large-scale enterprises are carried on through associations and the obvious question is “why?”

According to Coase², the answer is because operating as a firm is in truth cheaper than operating on an individual basis. This is because that the market has costs associated with its use, called transaction costs; such that buying a product on the market will lead to it costing more than

¹ See Chapter 2.
its true value. These costs can be segmented into: (1) the cost of discovering what the prices for the goods or services are; (2) the costs of negotiating and concluding each contract for each transaction; and (3) the cost of concluding the contract and monitoring its performance. So, for instance, if A wanted to run a butchery, he would have to go to the market and buy information about how much buying cattle, goats and pigs costs; and how much meat ordinarily costs on the market from B who specialises in such information. After that, A would need to negotiate a series of contracts with C, who owns a farm for the continual supply of the animals; and with D to find a market and sale the meat products. This would have to be repeated many times involving many contracts with B, C and D at varying costs. Coase proposes that it would much be cheaper for A to engage B, C and D on one long term contract thus cancelling out the costs associated with dealing with B, C and D separately; than to continually engage them on a series of short-term contracts in the manner described.

What Coase is arguing is that multiple-member enterprises emerge because people want to minimize the costs associated with conducting a business. Accordingly, the expansion in the scale-of-trade with the introduction of foreign trade in ancient Rome, medieval Europe and industrial Britain all stimulated and caused the rise of asset-intensive production methods, which placed a premium on legal forms suited to raising capital from multiple investors. These were the Societas Publicanorum, the Societas and the Chartered companies and joint stock companies respectively. These organisations allowed individuals to pool their capital and skill allowing for not only a large accumulation of funds from which to finance their venture, but also, the benefit of the wealth of expertise created by a group. Therefore, multiple-membership in a business is important because it

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4 Glenn Fox, The Real Coase Theorem, CatoJournal, Vol.27, No.3(Fall2007), p. 378  
by those members, unless they had some authority, apparent or actual; to bind the rest of the group. Thirdly, the death or exit of one or even all of the members of the group necessarily requires its dissolution so as to share its stock. Lastly, in terms of decision-making, acting in concert in a body constituting multiple individuals can be difficult because getting the unanimous consent of the entire body is not easy. To remedy these problems, the concept of separate personality developed. Separate personality is important, firstly, in that by distinguishing the enterprise from its members, the members are neither liable for the debts and liabilities of the enterprise nor is the enterprise liable for the debts and liabilities of its members. Lord Macnaghten echoed this position in Salomon v. A. Salomon and Co. Ltd\textsuperscript{12} when he stated that:

"The company is at law a different person altogether from the subscribers... nor are the subscribers, as members, liable in any shape or form [for the company's liabilities] except to the extent and in the manner provided by the Act."\textsuperscript{13}

This also means that the creditors of the members cannot recover the property of the business because that property is legally distinct from the members' property. Thus in Elias Chipimo and Charles Mkokweza v. Bradford Machila\textsuperscript{14} the respondent had given the property belonging to a company in which he was a shareholder for use by the partnership with the claimants. The primary issue before the arbitrator was inter alia whether the property was partnership property warranting it being shared between by the partners and the payment of rent by the partnership. It was held that since the property belonged to a company, which was distinct from the respondent; the attempted transfer of the property was void as the property never belonged to the respondent to give away. This encourages investments because the stock of the association is

\textsuperscript{12} [1897] A.C. 22 HL.
\textsuperscript{13} At P.51.
\textsuperscript{14} 2009/HPC/0554
shielded from the personal suits against its members leaving it sufficiently capitalised to continue with its business.

Furthermore, separate personality solves the problem of ‘privity to contract’, by treating the group of individuals composing the group as a single unit.\(^{15}\) Therefore, contracts entered into on behalf of the company by its directors are enforceable by and against the company thus allowing the company to sue and be sued in its own capacity. It also solves the problem of *dissolution upon change of membership* because since the business is distinct from its members, the death of exit or any or *indeed all* of its members will affect neither its personality nor its continuity. This point made evident in the Australian case of *Re Noel Tedman Holding PTY Ltd*\(^{16}\) where the only members of a company died in a road accident and the question before the court was whether the company had survived its only members. The court held that it had: this is because the members were legally distinct from the company; therefore, their death did not affect the continuity of the company.

Finally, separate personality solves the problem of decision-making by allowing the business, which is a ‘person’, to allocate the powers of the day to day management of the company in the hands of agents, usually a Board of Directors. In this manner it also provides the advantage that the business can employ experts to run its affairs and thus benefit from those individuals’ specialised knowledge.

The Companies Act allows for the creation of the limited company as a separate person. In section 22, the Company is conferred capacity to do things that any individual can do, subject to limitations imposed by the Act and limitations inherent from its corporate nature

**4.2.3 Limited Liability**


\(^{16}\) [1967] Qd R 561.
The leading exposition on civil liability was espoused by Lord Viscount Simonds in *Overseas Tankship (U.K.) Limited v. Morts Docks & Engineering Co. (The Wagon Mound No.1)*\(^{17}\) when he said: "It is a principle of civil liability that a man must be considered to be responsible for the probable consequences of his act."\(^{18}\) In this respect, limited liability entails shielding an individual his legal liability. It entails that the liability members of the association is limited to the amount that the members are obliged to contribute to the association. In case of companies limited by shares for example, upon being allotted shares, a member of a company is obliged to pay to the company the value of the shares such that should the company be wound up before he pays, he would be liable to contribute to the company’s debt, the value remaining unpaid on the shares.\(^{19}\)

Limited liability is important because, *inter alia* it fosters economic growth by encouraging investors to take risks.\(^{20}\) Before the evolution of limited liability, the rule was that the members of a multi-member business association were jointly and severally liable for the association’s debts and obligations in the event the same could not be paid from the pooled resources. Thus, the members’ estates were liable to be attached to the discharge of the debts and liabilities of the enterprise. Limited liability, therefore, encourages investment especially in risky ventures by giving the investors assurance that in the event of the enterprise failing, their obligations for the venture’s losses will not extend beyond the amount contributed in the enterprise. This, in a way puts investors’ minds at ease knowing that their estates are not at risk of being attached in paying off the business’ debts and allows them to even venture in businesses that are potentially risky.

Secondly, limited liability encourages investors to contribute capital especially in risky enterprises where they intend to play a passive role and do not have to personally monitor and

\(^{17}\) [1961] All ER 404.

\(^{18}\) At Page 413.

\(^{19}\) Section 17 (3) of the Companies Act.

supervise the business’ activities. This is because under the joint and several liability rule, any investors could be targeted by business’ creditors to recover the business’ debts. To protect themselves, investors would need to employ other people to ensure that all investors are liquid enough to indemnify the investor should he be made to shoulder all of the business’s debts; which would increase the cost of doing business. Limited liability therefore allows businesses to dispense with the need for monitoring costs by shielding investors from liability for the debts of the business. Limited liability is also important because it allows for freely transferable shares. This is because it reduces the need for owners to monitor each other’s personal affairs, thereby reducing the importance of restricting who may become an owner and promoting free transferability of shares. This makes sense: with limited liability, wealthy people would have no problems sharing the membership of a company with people who are barely solvent since they would not normally be asked to shoulder the liabilities of the enterprise.

In Zambia, limited liability is present to limited companies in that the Companies Act in section 17 (3) as restated in section 266 (1) provides that where a private company limited by shares is wound-up, a member shall be liable to contribute, an amount not exceeding the unpaid on the shares held by him. In relation to companies limited by guarantee, section 19 (6) as restated in section 265 (1), provides that where a company limited by guarantee is wound-up, a member is liable to contribute an amount not exceeding the amount specified in the declaration of guarantee made by him.

4.1.4 Transferable Shares

21 William J. Carney, Limited Liability, p. 670
The demand for a business organisation suited for large-scale commerce led to the evolution of *tradable-shares* as an attribute of a business organisation. The most famous definition of shares is that of Farwell J in *Borland’s Trustee v Steel Brothers* 23 where he states that:

"... a share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se* in accordance with [s 14]. ... A share is not a sum of money ... but is an interest measured by a sum of money and made up of various rights contained in the contract..." 24

Tradable shares have the advantage of permitting the business enterprise to access a virtually endless supply of capital especially where it is allowed to invite the public to obtain shares in the enterprise. 25 Apart from greater access to capital, the other advantage conferred by tradable or mobile shares, is ‘perpetual existence’. Firstly, shares are property, and like any other form of property they can be dealt with in various ways i.e. they can be sold, given away as a gift, bequeathed and indeed they can devolve to an deceased’s estate and the receiver of such shares becomes a shareholder. This allows for continuity of the enterprise in the sense that even where shares change hands, the identity of the enterprise and indeed its continuity is not affected.

The Zambian Supreme Court has affirmed this contention in many decisions including *Zambia Consolidated Copper Mines (ZCCM) and Ndola Lime Ltd v. Sikanyika and others, Newton Siulanda and Others v. Foodcorp Products Limited*, 26 and *Kankomba and Others v. Chilanga Cement Plc*. 27 All of these cases involved a dispute between employees and an employing company.

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23 [1901] 1 Ch 279.
24 At p. 288.
26 SCZ. Judgment No. 9 of 2002
27 SCZ. Judgment No 30 of 2002
which had or which was about to change its shareholders and the employees contended that the change in their employers’ shareholding would entail a change in their employers’ personality. The Supreme Court emphatically rejected these arguments, and in the ZCCM case Ngulube CJ (as he then was) in what has become the leading Zambian exposition on the topic, stated inter alia that:

"We must affirm right away that a change of ownership of shares cannot result in the corporate entity (Ndola Lime) becoming a new employer; they will still be the same employer and they will be bound by the contracts of employment which they already have with each of their workers individually and collectively...."

This attribute is important in that it facilitates corporate mergers and take-overs through the mere purchase of shares.

The Companies Act permits transferable shares firstly by treating shares like any other form of movable property under section 57; permitting the transfer of shares by operation of law upon a shareholder’s death under section 70; and by prohibiting public limited companies imposing restrictions on the transfer of shares under section 14 (5).

4.1.5 Ways of Borrowing

Apart from selling of shares, a company would need to raise funds to finance the running of the enterprise. Ordinarily, loans and mortgages form the primary modes through which business associations seek to raise the such funds and in the premise, since sole traders, partnerships and other forms of unincorporated associations have unlimited liability; it would seem sensible that they should have better access to loans since the lender can feel confident that in the event of default he would be able to proceed against the members’ estates which option, needless to say, is not available with regards to the limited company (apart from the unlimited liability company). However, this is not so: companies in fact enjoy better access to loans because the practitioners of

28 As in the ZCCM Case.
equity through time evolved an ingenious means for securing the indebtedness of a company that is not available to other forms of business associations. This is in the form of the *floating charge*. ²⁹

A floating charge is essentially a charge which floats like a cloud over the assets from time to time falling within a generic description, but without preventing the mortgagor from disposing of those assets in the usual course of business until something occurs to cause the charge to become crystallized and fixed. ³⁰ This type of a charge is particularly suitable for businesses that do not have fixed assets such as land which can be included in a normal mortgage; but has a large and valuable stock-in trade. The characteristics of a floating charge are stated by ROMER, L. J., in *Re Yorkshire Woolcombers’ Association* ³¹ when he opined that any mortgage by a company which contains the three following characteristics is a floating charge:

1. It is a charge on a class of assets, present and future;
2. That class is one which, in the ordinary course of business, would be changing from time to time; and
3. It is contemplated that until some steps are taken the company shall carry on its business in the usual way.

The floating charge is a superior form of security to the mortgage because it permits the company to use the property subject to the charge in the usual course of business. This is important because it is imperative that a company is able to turn over its property in running its business. Under an ordinary mortgage, however, legal title in the charged property passes to the charge with the consequence that the mortgagor or the borrower cannot deal with the property without the consent of the mortgagee or lender. Therefore, unlike under a floating charge, whenever the mortgagor wishes to dispose of or otherwise deal with the charged property, the consent of the

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³¹ [1903] 2 Ch. 284.
mortgagee would have to be sought, and whenever new property is acquired, a new mortgage agreement would have to be drawn, which do not arise under the floating charge.\textsuperscript{32}

The Companies Act under part V recognises the floating charge as one of the ways in which a charge over the company’s assets can be created and requires under section 99 (1) (d) that the same should be registered with the registrar of companies.

\textbf{4.2 How has the Limited Company Contributed to Economic Development in Zambia}

The company has been resorted to as a means of fostering economic development in Zambia in two prominent time periods, that is: the period after independence and the post-Kaunda era. In the period after independence, the company was used directly as the primarily means of transferring economic power from the foreigners to the locals through the government purchase of shares in enterprises in key sectors of the economy. This would be achieved by using the company’s feature of transferable shares, to obtain a controlling stake in the enterprises. In the post-Kaunda era, the company was to be used to encourage entrepreneurship, that is, to encourage private individuals to invest in Zambia under the economic liberalisation and privatisation programs.

After independence, the Kaunda regime felt that sustainable economic development would only be achieved if the government controlled all economic activities and if economic influence was transferred from the foreigners to the locals. This was because, as a result of a policy under the failed federation of Northern Rhodesia, Southern Rhodesia and Nyasaland where Zambia was to play the role of financier from its copper resources for the investments in Southern Rhodesia; at

\textsuperscript{32} L. B. C Gower et al, \textit{Gower’s Principles of Modern Company Law} p. 96.
independence Zambia had a weak economic base.\textsuperscript{33} The few companies that existed were mere branches of foreign companies, and those that were not, were in the held by foreigners.\textsuperscript{34}

In a bid stimulate economic development; Kaunda by the 'Mulungushi Declaration' 1968 and the 'Matero Declaration' of 1969, embarked of nationalisation programs requiring enterprises to transfer 51 percent of their shares to the government. Soon the government created the Mining Industry Development Corporation (MINDECO), as a holding company for mining industry interests; and the Finance Development Corporation (FINDECO) as a holding company for the public enterprises in the financial sector which were later fused into Zambia Industrial and Mining Corporation (ZIMCO), which became the holding company for all public sector enterprises.\textsuperscript{35} By 1989, ZIMCO had a turnover of K 29.8 billion and employed 136 000 people and was listed on the Forbes top 500 companies in the world\textsuperscript{36}. In addition to these measures, Kaunda created an additional 26 green field corporations which were placed under direct ministerial control.

As a result of these measures through the use of the corporate form, investments in the economy primarily by the government grew from US$ 180.4 million during 1954-64 to US$ 281.8 million in 1966-70. To add on, the country's economic growth rate increased from 1.1 percent per year between 1964 and 1968, to 2.3 percent from 1969 to 1972, and the business activity by the parastatal sector accounted for some 80 percent of national Gross Domestic Product (GDP).\textsuperscript{37}

The spark ignited by Kaunda under the measures mentioned above was however short-lived as a consequence of the increase in the oil prices and a plummeting of the copper prices in 1973

\textsuperscript{36} African Forum and Network on Debt and Development, \textit{The Impact of Structural Adjustment Programs in Zambia}. P.14.
\textsuperscript{37} African Forum and Network on Debt and Development, \textit{The Impact of Structural Adjustment Programs in Zambia}. 38
leading the country into decades of economic stagnation. Likewise, the Chiluba regime also looked to the company as a way of stimulating entrepreneurship and economic development. The new strategy was to encourage the private sector to participate in the economy primarily through the use of the company. The companies that were formerly under ZIMCO were to be removed from government ownership and sold to individuals. To facilitate this, the Zambia Privatisation Agency was created under the Zambia Privatisation Agency Act in 1992, to facilitate a transparent privatisation program and was funded by World Bank and other donors. To add on, the Companies Act was amended in 1994 to modernise it and make it better able to be used by the investors in the new liberalised conditions and to protect investors. Under the privatisation program, the company was a particularly ideal vehicle because of the attributes it possesses discussed above especially limited liability.

Following these economic liberalisation and privatisation programs, Chipwende observes that there was increased participation by the populace in the economic activities leading to a new entrepreneurial class of Zambians as well as improved profitability for privatised companies. This has also entailed that government funds which would have otherwise gone to subsidise the parastatals are used for social expenditure on health, education and broader tax base. Cheelo and Munalula conducted an empirical study of the effect of privatisation on Zambian entrepreneurs involving a survey of 48 companies, including 32 (formally state owned) privatized firms, 9 always private firms and 7 state owned enterprises. The research concluded that privatised companies, which were largely owned by private individuals, out-performed the other companies either in terms of profitability, market share and employment (in the long-term). It also showed that the liberalised

conditions that came with the privatisation of companies have increased the number of citizens investing in the economy as well as foreign investments which stood at $207 million in investment inflows by 1997.40

Largely as a consequence of these measures, since the privatisation programs began, Zambia has posted economic growth at an average of almost 5% between 1999 and 2005 and to 7% in 2007.41

4.3 Conclusion

The essay sought to show that the company, despite it being a creature of Zambia’s former colonial masters and not having been completely fashioned by Zambian culture; is still a good business organisation. This is because it embodies all of the primary features of business associations that have emerged in history in different societies. It, for example, embodies multiple-membership, it is a separate person from its members, its members enjoy limited liability, it has tradable shares and it can utilise the floating charge, which is the most efficient way to charge a business’ assets to secure its indebtedness.

In Zambia, the company has been utilised to facilitate economic development in two eras. Under the Kaunda regime, its attribute of transferable shares was taken advantage of to allow the Kaunda government to obtain a controlling stake in 80 percent of the enterprises in the economy as a way of ensuring the economic development of the country with it guiding all economic activity in the country. Under the Chiluba regime, it was used to promote private participation in the economy. This was through the privatisation program which entailed the sale of companies which had formerly been under government control to private individuals and liberalising the economy to attract even foreign participants.

Chapter 5: Conclusion and Recommendations

5.1 Conclusion

The main objective of the research was to show that Zambia has good institutions using the limited company as a case study. To achieve this purpose, the essay resolved a number of hypotheses.

Chapter 2 showed that social institutions are moulded by the forces in a society and how efficient they are is measured by how best they perform the function they are created to respond to. It also proposed that whereas it is true that the best institutions are those that naturally evolve out of a society, an institution adopted by another society can be efficient provided it embodies certain features that would respond to the problems in that society.

Chapter 3 showed that, there is indeed a definite link between entrepreneurship and economic development which makes it important that appropriate business organisations are created to encourage its emergence in society.

Chapter 4 showed that despite the limited company not having fully been created in Zambia, it still embodies some key features which include: ‘Multiple-membership’, ‘separate personality’, ‘limited liability’, ‘transferable shares’, and ‘the floating charge’. These in many respects respond to many problems faced by businessmen in Zambia by encouraging investments in the manner discussed. Therefore, the chapter concluded that the company is a good institution. It also showed that using the features above, the company was used by the Kaunda and the Chiluba government to foster their immediate needs of economic development.

However, some steps can be taken to further improve companies as business institutions in Zambia.
5.2 Limitations in the present limited companies in Zambia

The biggest problem being faced by companies in Zambia is that the Companies Act has not been sufficiently modernised to suit the changing economic trends not only in Zambia but the world over. Firstly, the Zambian Companies Act does not provide sufficient measures to ensure ‘accountability’ to the shareholders by the directors. Modern companies the world over are characterised by a complete separation between ownership which is retained by the owners; and _de facto_ control which resides in the hands of the board of directors.¹ The problem that emerges is that it is difficult for the shareholders, especially in public companies where no single shareholder has a controlling interest²; to compel the directors to act in the best interests of the company. This is because the directors owe fiduciary duties to the company and not the individual shareholders and aside from removing the directors from the office and altering the company’s articles of association; there is little the shareholders can do. This lack of accountability is likely to lead to corporate disasters like the collapse of Enron and WorldCom in the United States; the Maxwell Publishing empire in the United Kingdom, Fidentia, LeisureNet and Regal In South Africa to mention but a few.

Another weakness in the Zambian Companies Act is that it does not have enough provisions for aiding ailing companies back to profitability. For example, when a company in Zambia is facing the prospects of insolvency, its options include _inter alia_ effecting a corporate merger, facilitating being taken over by another company, arranging a scheme of arrangement with a class of its shareholders or its creditors. Effecting a take-over or merger depends on the approval of the Competition and Consumer Protection commission and may therefore not always be available. To add on, all these measures have the common defect that they involve a

² Lorraine, Talbot, _Critical Company p.110._
termination or alteration of the interests of the shareholders and the creditors in the company concerned, meaning that very few stakeholders would want to resort to these measures. Some jurisdictions have devised ways of ensuring that the company is returned to profitability without affecting the interests of the shareholders, creditors or employees.

In South Africa, for example, the Companies Act of 2011 introduced another mode of saving ailing companies known as Business Rescue under sections 128 to 154 of the Act. This scheme involves three stages: The first stage involves the placing of the company under supervision and management of a business rescue practitioner. On this stage, a Business rescue practitioner is appointed to manage the affairs of the company in the board of director’s stead and he is given powers to delegate the management to the board of directors in the duration of the process. The second stage, involves placing the company in a ‘moratorium’ where no proceedings can be brought or maintained against the company and during which financing is acquired to fund its resuscitation. The last stage involves the formulation of a Business Rescue plan by the business rescue practitioner which lays down the process to be adopted to bring the company back to profitability. This scheme ensures that the company can be placed into something like a ‘time-out’, allowing it to replenish its capital, re-strategise and be restored back to profitability without affecting the interests of the stakeholders.

5.3 Recommendations

5.3.1 Introduction of general codes of good governance

To further strengthen the limited company in Zambia, it is recommended that Zambia modernises the Companies Act to include measures which will ensure that that directors are accountable to the shareholders by adopting a code of Good Corporate Governance. This step has been taken by the United Kingdom (in 2006), Australia (2004), Italy and Switzerland (2008)
to mention but a few. This can encourage people to use the corporate form when they feel that directors will not use the company to meet their own ends. Whereas the banking sector has laid down some codes of good corporate governance, through the Banking and Financial Services Risk Management Guidelines 2008, the Banking and Financial Services (Corporate Governance) Guidelines 2006 and the Banking and Financial Services Risk Guidelines issued by the Bank of Zambia; no general code of corporate governance exists for companies in general.

5.3.2 Introduction of more methods of rescuing ailing companies

It is recommended further that the Zambian Companies Act adopts a scheme similar to the South African ‘Business Rescue Scheme’ as a way of encouraging the continuation of companies that are financially distressed. This process is better than corporate mergers, takeovers or schemes of arrangement because not only does it leave the stakeholder’s interests unaltered; therefore stakeholders would more readily resort to it than the available measures. Secondly, since its operation would not depend on the authorisation of any administrative authority apart from the courts that would have supervise its use to ensure that it is not used for ulterior or collateral purposes; it would also be more readily available to the company’s stakeholders. The net result would be that more companies that would otherwise have been wound up would be saved and restored to profitability without altering the interests of the stakeholders in the company.
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