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# Small companies and regulatory tiering: a legal and economic analysis of Zambia's new regime

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## SUMMARY

In 2017, Zambia adopted a new Companies Act. The main purpose of the new Act is to promote the development of Zambia's economy through efficient regulation of companies. This article focuses on the small companies regime that the new Act introduces. More specifically, the article explores the extent to which the new small companies regime is fit for purpose by conducting a comparative analysis of that regime with the United Kingdom's (UK's) small companies regime in light of relevant literature, particularly literature in the field of regulatory economics. Overall, the analysis suggests that Zambia's small companies regime is largely inapt to achieving its intended purpose. The article's main argument in this connection is threefold. First, the new Act is somewhat at odds with its intended purpose insofar as it requires small companies to appoint a secretary. Exempting small companies from this requirement, as does the UK Companies Act of 2006, could better serve the purpose of the new Act. Second, whilst the exemption of small companies from the requirement to appoint auditors may be desirable, the 50 per cent shareholding threshold required for shareholders to demand an audit could inhibit controlling shareholder accountability and thus undermine the purpose of the new Act. A lower threshold such as the one applicable under the UK Companies Act, that is to say, ten per cent, could better serve the purpose of the new Act. Third, the lack of any special treatment for small companies as such vis-à-vis bookkeeping and financial reporting requirements could undermine the purpose of the new Act. Imposing lighter bookkeeping and financial reporting requirements on small companies, as does the UK Companies Act, could better serve the purpose of the new Act.

## 1 Introduction

On 17 November 2017, the Zambian Parliament adopted a new Companies Act (the new Act or the Act)<sup>1</sup> which repealed and replaced the 1994 Companies Act (the repealed Act).<sup>2</sup> The new Act came into force on 15 June 2018.<sup>3</sup> According to the Preamble thereto, the new Act seeks "to promote the development of the economy by encouraging entrepreneurship, enterprise efficiency, [and] flexibility and simplicity in

1 Companies Act 10 of 2017 (new Act).

2 Companies Act 26 of 1994 (repealed Act). See s 376 of the new Act.

3 Companies Act (Commencement Order) SI 47 of 2018.

the formation and maintenance of companies” in Zambia. In other words, the main purpose of the new Act is to promote the development of Zambia’s economy through efficient regulation of companies. Whilst it replicates most of the provisions of the repealed Act, an Act which drew on English company law as part of the colonial heritage, the new Act does transform Zambia’s company law in various respects.

Some of the notable reforms which the new Act introduces include the following. First, the new Act prescribes the qualifications for appointment to the office of company secretary and codifies the duties of company directors and company secretaries alike.<sup>4</sup> Second, where applicable, the new Act requires shareholders to disclose the beneficial owners of the shares they hold in a company at the time of incorporation and henceforth requires companies to maintain a (share and) beneficial ownership register and to notify the Registrar of Companies of any changes made to the register.<sup>5</sup> Third, the new Act provides for mandatory audit firm rotation following the appointment by a company of one audit firm for a continuous period of six years.<sup>6</sup> Fourth, the new Act introduces a small companies regime with a view to lessening the regulatory burden on small companies.<sup>7</sup>

Whether the new Act is indeed apt to promote the development of the country’s economy through efficient regulation of companies is, however, still open to question. Even leaving aside the general drawbacks of the transformative provisions that it introduces,<sup>8</sup> the new Act is laden with apparent drafting errors which could render compliance difficult and costly as only company law experts may be able to help companies get around some of those errors.<sup>9</sup> This article does not,

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4 Part VII of the new Act.

5 Ss 12(3)(e), 21(3), 30, 123, and 195 of the new Act, read together with the Companies (Amendment) Act 12 of 2020.

6 S 257(3) of the new Act.

7 Ss 82(6), 253(5), 263, and 264 of the new Act.

8 See generally Cameran, Negri and Pettinicchio “The Audit Mandatory Rotation Rule: The State of the Art” 2015 *Journal of Financial Perspectives* 1; Sayne, Westenberg and Shafaie “Owning Up: Options for Disclosing the Identities of Beneficial Owners of Extractive Companies” 2015 [https://resourcegovernance.org/sites/default/files/nrgi\\_Beneficial%20Owners2015-0820.pdf](https://resourcegovernance.org/sites/default/files/nrgi_Beneficial%20Owners2015-0820.pdf) (last accessed 2023-05-26); Lakhani “Imposing Company Ownership Transparency Requirements: Opportunities for Effective Governance of Equity Capital Markets or Constraints on Corporate Performance” 2016 *Chi.-Kent J Int’l & Comp L* 122.

9 For example, ss 29(1)(a), and 81 of the new Act refer to an office called the “registered records office”, and yet the Act itself requires companies only to have a “registered office” (s 28). Ss 3, 157, 188, 196, 197, and 199 similarly refer to the “share register”, and yet the Act itself does not require companies to maintain such a register. Rather, it requires companies to maintain several registers bearing rather duplicative names, including the “register of members”, “register of beneficial owners”, and “share and beneficial ownership register” (ss 30, 195, and 196). S 61(8) also erroneously refers to sub-s (6) instead of sub-s (7). S 188 similarly makes a wrong cross-reference to s 194 instead of s 195(3). Worse, s 70 is unintelligibly ungrammatical.

however, delve into the drafting errors thus envisaged. Rather, it focuses only on the new small companies regime. More specifically, the article explores the extent to which the new small companies regime is fit for purpose by conducting a comparative analysis of that regime with the United Kingdom's (UK's) small companies regime in light of relevant literature, particularly literature in the field of regulatory economics. The UK appears to be a suitable comparable jurisdiction since the new Act draws mainly on English company law.

Accordingly, the remainder of the article is organised as follows. Section 2 provides context by explaining more generally why and how the government may pursue "regulatory tiering", that is to say, the imposition of differential regulatory requirements on businesses according to firm size. Section 3 elaborates upon the nature of firms to which Zambia's small companies regime, in comparison to the UK's regime, applies. Section 4 in turn examines, in light of relevant literature, the substantive provisions of Zambia's small companies regime in comparison to the corresponding provisions of the UK's regime with a view to establishing the extent to which Zambia's regime is fit for purpose. Section 5 concludes the article.

## 2 Why and how the government may pursue regulatory tiering

Government regulation (including taxation) of businesses is needed to achieve overall social welfare.<sup>10</sup> All regulation, however, involves costs.<sup>11</sup> To produce, monitor compliance with, and enforce regulations, the government itself incurs direct costs. The government pays these costs using public funds.<sup>12</sup> Regulated firms, for their part, primarily incur compliance costs.<sup>13</sup> Unregulated third parties could also incur direct costs, but typically incur indirect costs as regulated firms tend to shift at least some of their regulatory compliance costs to consumers, in particular by raising the prices of the goods and services they supply to consumers.<sup>14</sup> Overall, the costs of government regulation include both fixed costs and variable costs, the latter being a function of the size of the regulated transaction.<sup>15</sup>

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10 Bickerdyke and Lattimore "Reducing the Regulatory Burden: Does Firm Size Matter?" 1997 <https://www.pc.gov.au/research/supporting/regulatory-burden-firm-size> (last accessed 2023-05-26); Centre for Economics and Business Research "Impact of Government Policy Index" 2019 <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/igpi-2019-final.pdf?sfvrsn=0> (last accessed 2023-05-26) 6.

11 See Bradford "Does Size Matter? An Economic Analysis of Small Business Exemptions from Regulation" 2004 *Journal of Small and Emerging Business Law* 5-15.

12 In Zambia, the legal definition of "public funds" is provided for in s 2 of the Public Finance Management Act 1 of 2018.

13 Bradford 2004 *Journal of Small and Emerging Business Law* 6.

14 As above.

15 As above.

Regulated firms, in particular, shoulder a number of compliance costs.<sup>16</sup> These include the costs involved in meeting the substantive requirements of a regulatory framework, the administration and paperwork costs involved in complying with a regulatory framework, the costs arising from the disincentives, distortions, and duplication attributable to a regulatory framework, as well as other costs (such as psychological stress) associated with regulatory compliance.<sup>17</sup> Importantly, there are economies of scale in regulatory compliance that arise not only due to fixed costs but also, albeit on occasion only, variable costs of compliance.<sup>18</sup> This has been confirmed by numerous empirical studies which demonstrate an inverse relationship between the size of a regulated firm and the per-unit cost of regulatory compliance.<sup>19</sup>

Large businesses can average fixed (and variable) costs over a larger quantity of output, thereby achieving a competitive advantage over their smaller rivals.<sup>20</sup> By the same token, the imposition of uniform regulatory requirements on all businesses tends to have a disparate impact on small businesses.<sup>21</sup> Small businesses “generally face higher compliance costs per unit of activity (turnover, production, number of employees and so on) as a result of not having economies of scale in learning about and complying with regulations.”<sup>22</sup> Empirical evidence shows that these economies of scale persist over time.<sup>23</sup> They do not, therefore, arise only from the short-run transition costs of adjusting to new regulatory requirements.

In short, the imposition of uniform regulatory requirements on all businesses has a disparate impact on small businesses due to the economies of scale associated with regulatory compliance.<sup>24</sup> Large firms typically have resources that enable them to deal with compliance costs

16 As above.

17 Bickerdyke and Lattimore 1997 1.

18 Bradford 2004 *Journal of Small and Emerging Business Law* 14.

19 See generally Brock and Evans “The Economics of Regulatory Tiering” 1985 *Rand Journal of Economics* 398; Bickerdyke and Lattimore 1997 59-72; Chittenden, Kauser and Poutziouris “Regulatory Burdens of Small Business: A Literature Review” 2002 [https://www.researchgate.net/publication/253551592\\_Regulatory\\_Burdens\\_of\\_Small\\_Business\\_A\\_Literature\\_Review](https://www.researchgate.net/publication/253551592_Regulatory_Burdens_of_Small_Business_A_Literature_Review) (last accessed 2023-05-26); Chittenden, Kauser and Poutziouris “PAYE–NIC Compliance Costs: Empirical Evidence from the UK SME Economy” 2005 *International Small Business Journal* 635; Chambers, McLaughlin and Richards “Regulation, Entrepreneurship, and Firm Size” 2018 <https://ssrn.com/abstract=3169332> (last accessed 2023-05-26).

20 Brock and Evans 1985 *Rand Journal of Economics* 399.

21 As above.

22 Douglas and Pejoska “Regulation and Small Business” 2017 <http://www.treasury.gov.au/publication/p2017-t213722a> (last accessed 2023-05-26).

23 Bradford 2004 *Journal of Small and Emerging Business Law* 15; Brock and Evans 1985 *Rand Journal of Economics* 399.

24 Verkuil “A Critical Guide to the Regulatory Flexibility Act” 1982 *Duke Law Journal* 213; Brock and Evans 1985 *Rand Journal of Economics* 399; Bradford 2004 *Journal of Small and Emerging Business Law* 15; Douglas and Pejoska 2017 4.

and hire expert staff who can identify the most cost-effective ways of ensuring regulatory compliance.<sup>25</sup> Some large firms even have a compliance department staffed by experts who can benefit from the learning curve effect and reduce the per-unit cost of compliance, thereby maximising the scale efficiencies associated with regulatory compliance.<sup>26</sup> Small firms, on the other hand, are typically more resource-constrained.<sup>27</sup> They typically rely on one individual or a handful of key decision-makers to manage the compliance function.<sup>28</sup> Regulatory compliance costs thus place small firms at a competitive disadvantage vis-à-vis their larger rivals.<sup>29</sup> By the same token, government regulation might discourage new market entrants (as regulatory economies of scale operate as a barrier to entry) and constrain the performance of existing firms or even force them out of business, thereby leading to lower investment, less innovation, fewer people being employed by small businesses, higher prices (due to lack of market competition) and hence inefficient markets.<sup>30</sup>

As a policy response, regulatory tiering is an attempt at cutting the costs of regulation to small businesses. It is thus designed as an antidote to the disproportionate impact on small firms of the uniform, “one-size-fits-all” regulatory approach.<sup>31</sup> It is worth underlining, however, that regulatory tiering is socially optimal if and only if it increases the net social benefit of regulation by eliminating applications of regulation that result in a net social loss.<sup>32</sup> The net social benefit of any regulation is the difference between the marginal social benefit and the marginal social cost of that regulation.<sup>33</sup> The marginal social benefit of regulation derives from the reduction in the risk or severity of the harm which a given regulation is designed to address whilst the marginal social cost includes “compliance costs on businesses and individuals, administration costs, monitoring and enforcement costs and indirect costs (such as competition and innovation costs).”<sup>34</sup> All things being equal, in view of regulatory economies of scale, the larger the regulated firm the greater the net social benefit of regulation, and the smaller the regulated firm the greater the net social loss.<sup>35</sup> This explains why regulatory tiering may be a good policy choice.

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25 Douglas and Pejoska 2017 4.

26 As above.

27 As above.

28 As above.

29 As above.

30 Centre for Economics and Business 2019 6.

31 As above.

32 Douglas and Pejoska 2017 5.

33 As above.

34 As above.

35 Bradford 2004 *Journal of Small and Emerging Business Law* 17-20; Douglas and Pejoska 2017 5-8.

When the transaction costs of regulatory tiering, the cumulative effects of regulation, and other “real-world” variables are considered, however, the case for regulatory tiering becomes more intricate and ambiguous.<sup>36</sup> Indeed, regulatory tiering could produce significant undesirable effects.<sup>37</sup> It could, for example, serve to preserve inefficient small firms that decrease social welfare, operate as an incentive for large firms to become smaller in order to benefit from regulatory exemptions or lighter regulatory requirements, or indeed operate as a disincentive for small firms to grow beyond the tiering thresholds in order to continue enjoying regulatory exemptions or lighter regulatory requirements.<sup>38</sup> Regulatory tiering could also increase the transaction costs of business regulation as it creates the need for integrity rules, thereby making both regulatory compliance and enforcement more costly.<sup>39</sup>

Moreover, despite imposing direct costs and constraints on businesses, government regulation can create indirect opportunities and enable activities that could be beneficial to businesses.<sup>40</sup> The indirect influence of regulation on business performance thus envisaged largely depends on how the regulated firms and the stakeholders with whom they interact (such as employees, customers, suppliers, competitors, and creditors) respond and adapt to regulation. Mandatory financial disclosure and reporting requirements, for example, tend to reduce information asymmetries between firms and their external stakeholders, thereby reducing the cost of capital.<sup>41</sup>

In practice, regulatory tiering can be applied to any aspect of regulation, including substantive regulatory requirements, recordkeeping requirements, monitoring efforts, penalties for non-compliance, etc.<sup>42</sup> Essentially, however, there are two main ways in which regulation can be tiered. First, the government may impose lighter regulatory requirements on small firms.<sup>43</sup> For example, small firms may be “required to comply with less stringent standards or meet less onerous reporting and record keeping requirements.”<sup>44</sup> Second, the government

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36 Bickerdyke and Lattimore 1997 72; Bradford 2004 *Journal of Small and Emerging Business Law* 27.

37 Brock and Evans 1985 *Rand Journal of Economics* 406.

38 See e.g. Garicano, Lelarge and van Reenen “Firm Size Distortions and the Productivity Distribution: Evidence from France” 2016 *American Economic Review* 3439.

39 Douglas and Pejoska 2017 9.

40 Kitching, Hart and Wilson “Burden or Benefit? Regulation as a Dynamic Influence on Small Business Performance” 2015 *International Small Business Journal* 130.

41 See generally Healy and Palepu “Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature” 2001 *Journal of Accounting and Economics* 405; Beyer, Cohen, Lys and Walther “The Financial Reporting Environment: Review of the Recent Literature” 2010 *Journal of Accounting and Economics* 266.

42 Brock and Evans 1985 *Rand Journal of Economics* 406; Bickerdyke and Lattimore 1997 xi.

43 Bickerdyke and Lattimore 1997 xiv.

44 As above.

may exempt small firms from certain regulatory requirements. Small firms may, for example, “be exempted from the substantive requirements of a regulation (or tax), or from associated regulatory requirements such as record keeping or inspection programs.”<sup>45</sup>

Providing for an exemption of small firms from regulation is the simpler of the two forms of regulatory tiering. It is not, however, always the best policy option. A major drawback of this form of regulatory tiering is that “it does nothing to address risks created by the businesses covered by the exemption. If these risks are significant or the consequence serious if the risk eventuates, a better approach may be to apply a lighter touch version of the regulation to small businesses.”<sup>46</sup> A major drawback of tiering by lighter regulation on the other hand is that it delivers less societal protection, especially when it is applied to relatively large businesses.

### 3 Small companies under the new Act

Under the new Act,<sup>47</sup> as under the repealed Act,<sup>48</sup> a company can be incorporated either as a public company or as a private company. A public company can only be incorporated as a company limited by shares, whereas a private company may be incorporated as a company limited by shares or by guarantee, or as an unlimited company.<sup>49</sup> The new Act has introduced regulatory tiering in favour of “small” private companies.<sup>50</sup> It defines a small private company as “any business enterprise whose total investment, excluding land and buildings, annual turnover and the number of persons employed by the enterprise, does not exceed the prescribed numerical value.”<sup>51</sup>

At first blush, the term “small private company” suggests that only a private company may qualify as small. If this is the correct position, a public company (whether listed or not) can never qualify as small. The definition that the new Act itself provides does not, however, explicitly say so. Therefore, one cannot completely rule out the applicability of the new small companies regime to public companies as the generic expression “*any* business enterprise” captures private companies and public companies alike. This is in stark contrast to the UK Companies Act of 2006 (the UK Companies Act) which explicitly excludes the applicability of the small companies regime to public companies and, generally, (for reasons of public interest) to certain categories of

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45 As above.

46 Douglas and Pejoska 2017 7.

47 S 6 of the new Act.

48 S 13 of the repealed Act.

49 Ss 6-11 of the new Act.

50 Ss 82(6), 253(5), 263, and 264 of the new Act.

51 S 3 of the new Act.

companies such as insurance firms and banks, whether or not these are incorporated as private companies.<sup>52</sup>

The lack of similar clarity under the new Act can be a source of legal uncertainty and thus inefficiency. To avail themselves of the new regime, companies must be able to determine whether or not the regime applies to them. The task of making such a determination itself involves transaction costs in the form of information costs.<sup>53</sup> The definition of a small private company given by the new Act leaves public companies in doubt as to whether or not the small companies regime applies to them. This could serve only to increase information costs. Public companies seeking to avail themselves of the new regime must consult experts to determine whether they can qualify as small. Moreover, the ambiguity of the definition of a small private company could give rise to disputes between the public companies concerned and other stakeholders, thereby engendering inefficient litigation.

Setting these observations aside, the three numerical values that the new Act refers to in its definition of a small private company are prescribed by the Companies (General) Regulations 2019.<sup>54</sup> To qualify as small, according to regulation 3 thereof, a private company must satisfy the following three conditions. First, its total investment, excluding land and buildings, must not exceed 1,666,667 fee units (i.e. K500,000),<sup>55</sup> if the company concerned is a manufacturing company, or 1,000,000 fee units (i.e. K300,000)<sup>56</sup> if the company concerned is a trading or service company. Second, its annual turnover must not exceed K800,000. Third, it must employ less than 100 people.

This definition of small private companies captures small and medium-sized enterprises (SMEs). The Zambian government currently defines SMEs as businesses employing less than 100 people.<sup>57</sup> SMEs thus constitute the very backbone of Zambia's economy. They are estimated to represent 97 per cent of all businesses, 70 per cent of the gross domestic product (GDP), and 88 per cent of employment in the

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52 S 384 of the UK Companies Act of 2006 (UK Companies Act), as amended by Markets in Financial Instruments Directive (Consequential Amendments) Regulations SI 2932 of 2007; Companies and Partnerships (Accounts and Audit) Regulations SI 2005 of 2013; Companies, Partnerships and Groups (Accounts and Reports) Regulations SI 980 of 2015; and Occupational Pension Schemes (Master Trusts) Regulations SI 1030 of 2018.

53 Bradford 2004 *Journal of Small and Emerging Business Law* 8-9.

54 Companies (General) Regulations SI 14 of 2019. These regulations were issued pursuant to s 375 of the new Act.

55 Reg 2 of the Fees and Fines (Fee and Penalty Unit Value) (Amendment) Regulations SI 41 of 2015 currently pegs a fee unit at K0.30. See Fees and Fines Act 13 of 1994, as amended by Act 11 of 2013, ss 3 and 9.

56 Fees and Fines (Fee and Penalty Unit Value) (Amendment) Regulations, reg 2.

57 International Trade Centre "Promoting SME Competitiveness in Zambia" 2019 <http://www.zda.org.zm/wp-content/uploads/2020/09/Zambia-Small-and-Medium-Enterprises-Survey-Report.pdf> (last accessed 2023-05-26).

country.<sup>58</sup> Interestingly, in the UK, SMEs are said to account for as high as 99.9 per cent of the total number of businesses and 61 per cent of the private sector workforce.<sup>59</sup> It must be noted, however, that the UK government currently defines SMEs much more broadly than the Zambian government. Unlike in Zambia where only businesses that employ less than 100 employees are regarded as SMEs, in the UK, all businesses that employ up to 249 employees are regarded as SMEs, at least in relation to government procurement activities, provided their annual turnover and balance sheet total do not exceed €50,000,000 and €43,000,000, respectively.<sup>60</sup>

It should also be noted that it is not all SMEs that qualify as small for purposes of regulatory tiering. In Zambia, in particular, only SMEs that are incorporated as private companies and that satisfy *all* the three metrics prescribed by the Companies (General) Regulations qualify as small under the new Act. Under the UK Companies Act, by contrast, a company qualifies as small in relation to a specific financial year if that company satisfies at least *two* rather than all the three qualifying metrics prescribed by that Act, that is to say, if its turnover does not exceed £10,200,000, its balance sheet total does not exceed £5,100,000 and the average number of people employed by the company during the year does not exceed 50.<sup>61</sup> UK company law thus uses the metric “balance sheet total” instead of the metric “total investment” used under the new Act. The UK Companies Act defines the former as the aggregate of the amounts shown as assets in the company’s balance sheet.<sup>62</sup> This definition does not exclude the value of land or buildings as does the new Act. The reasoning behind these regulatory divergences is not obvious. Suffice it to say that contextual differences, particularly with respect to the level of economic development, might have a role to play.

In any event, a company that qualifies as small in the UK may not qualify as small in Zambia. Indeed, even some “micro-entities”, companies that fall under a lower regulatory tier than small companies, in the UK may not qualify as small in Zambia. A company qualifies as a micro entity under the UK Companies Act if, in relation to a specific financial year, that company satisfies at least two of the possible three defining metrics, that is to say, if its turnover does not exceed £632,000, its balance sheet total does not exceed £316,000 and the average

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58 As above.

59 Department for Business, Energy & Industrial Strategy “BEIS Small and Medium Enterprises (SMEs) Action Plan: 2022-2025” 2023 <https://www.gov.uk/government/publications/beis-small-and-medium-enterprises-sme-action-plan-2022-to-2025> (last accessed 2023-05-26).

60 As above.

61 S 382 of the UK Companies Act, as amended by Small Companies (Micro-Entities’ Accounts) Regulations SI 3008 of 2013; and Companies, Partnerships and Groups (Accounts and Reports) Regulations.

62 S 382(5) of the UK Companies Act.

number of people employed by the company during the year does not exceed ten.<sup>63</sup> The two financial metrics, in particular, are far much higher than those that are used to define a small private company in Zambia.

It would therefore appear that Zambia's new small companies regime is more restrictive than inclusive. Whereas a considerable number of private companies might satisfy the last qualifying condition concerning the number of employees (i.e. employing less than 100 people), the total investment and annual turnover of many relatively small companies are likely to exceed the prescribed qualifying financial metrics. This holds true even though land and buildings ought to be excluded from the value of the total investment.

As noted above, when deciding on the tiering thresholds, it is important to consider the regulatory economies of scale which could place relatively small companies at a competitive disadvantage. If many small companies are to benefit from the new regime, the thresholds should be as high as desired. On the other hand, it is also important to consider the possible behavioural incentives and consequential risks of regulatory tiering referred to above. Indeed, balancing the need to relieve small companies of regulatory costs against the need to mitigate the possible negative effects of regulatory tiering is a complex affair. Whether the Companies (General) Regulations strike an optimal balance in the Zambian context is an empirical question that cannot be answered here. One can only hope that the new regime will not operate as an incentive for companies to become smaller or indeed as a disincentive for small companies to grow beyond the prescribed tiering thresholds in order to enjoy or to continue enjoying a more flexible regulatory regime as evidence has shown elsewhere.<sup>64</sup> Given that the financial tiering thresholds are rather low, this could significantly undermine the purpose of the new Act of promoting economic development.

## 4 Tiered provisions of the new Act

The new Act adopts both forms of tiering identified above. It imposes lighter regulatory requirements on small private companies with regard to the qualifications of persons who may be appointed to the office of the company secretary. The new Act also exempts small private companies from the requirement to have their annual accounts audited. It does not, however, provide for preferential treatment of small private companies as such with regard to bookkeeping and financial reporting requirements.

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63 S 384A of the UK Companies Act, as amended by Small Companies (Micro-Entities' Accounts) Regulations.

64 See e.g. Garicano, Lelarge and van Reenen 2016 *American Economic Review* 3439.

## 4 1 Qualifications of company secretary

The new Act requires every company to appoint a secretary.<sup>65</sup> This is a mandatory requirement to which there is no exception. It is incumbent upon the board of directors to ensure that any vacancy in the office of the company secretary is filled within 60 days from the date the vacancy occurs.<sup>66</sup> Any failure to do so is an offence punishable upon conviction with a fine of up to 3,000 penalty units (i.e. K900).<sup>67</sup> Importantly, as a general rule, not everyone qualifies for appointment as a company secretary. An individual may be appointed as a company secretary only if that individual is a resident of Zambia and is either a legal practitioner, a chartered accountant, or a member of the chartered institute of secretaries.<sup>68</sup> A body corporate also qualifies for appointment provided it is incorporated in Zambia and has an officer who qualifies for appointment as a company secretary.<sup>69</sup>

These qualifications do not, however, apply to a company secretary appointed by a small private company.<sup>70</sup> Thus, whilst it is mandatory for every company to have a secretary, a small private company may appoint any individual or body corporate as its secretary even if that individual or body corporate does not satisfy the foregoing qualifications. This regulatory flexibility in favour of small private companies, so it appears, is designed to save such companies the costs associated with employing qualified professionals. Indeed, it may be too costly for a small company to employ any of the three categories of professionals specified by the new Act as their remuneration expectations do not generally vary according to firm size. The non-applicability to small companies of the prescribed qualifications for a company secretary, one may argue, could therefore incentivise the formation and facilitate the maintenance of small companies that may be financially constrained.

Be that as it may, a person who is not a qualified lawyer, chartered accountant, or trained company secretary may not be competent enough to discharge the duties that the new Act imposes on company secretaries.<sup>71</sup> First, a company secretary must provide the directors, both collectively and individually, with guidance on their duties, responsibilities, and powers. Second, a company secretary must advise the board of directors not only on the legislative provisions that regulate the meetings of shareholders and the board of directors, the preparation of reports pertaining to the operations of the company, and the submission of documents by the company to relevant authorities but also on the implications of any failure to comply with such regulatory

65 S 82(1) of the new Act.

66 S 82(8) of the new Act.

67 S 82(9) of the new Act, as read together with Fees and Fines (Fee and Penalty Unit Value) (Amendment) Regulations, reg 2.

68 S 82(5) of the new Act.

69 Ss 82(5) and 84 of the new Act.

70 S 82(6) of the new Act.

71 See s 83 of the new Act.

requirements. Third, a company secretary must ensure that the minutes of the meetings of both the shareholders and board of directors of the company are properly recorded and that company registers are properly maintained. Fourth, a company secretary must ensure that the company maintains up-to-date information on the beneficial ownership of all the shares of the company and their associated voting rights. Fifth, a company secretary must ensure that the company is compliant with the new Act in relation to the lodging of documents with the Registrar of Companies. Sixth, a company secretary must bring to the attention of the board of directors any failure on the part of the company or a director to comply with the company's articles of association or the new Act itself.

It should be obvious that a person who has not been trained in company law cannot be reasonably expected to competently discharge these duties. Yet, this is exactly what the law expects of all company secretaries regardless of their qualifications. The new Act even empowers the High Court, upon application by a company, a creditor of the company, or the Registrar of Companies, to disqualify a person from being appointed to the office of company secretary for a period of up to five years upon conviction for an offence or breach of any of the duties of company secretaries prescribed by the Act.<sup>72</sup> What this means in practice is that a small private company may not be able to take advantage of the regulatory relief that the new Act provides vis-à-vis the qualifications of company secretaries. The complexity of the duties that the law imposes on company secretaries makes it necessary for small companies and large companies alike to appoint only those who satisfy the prescribed qualifications. By the same token, and given the penalty that the new Act imposes for any failure to fulfil the duties of the office, no prudent person would accept an appointment as a company secretary unless one has acquired the necessary training to perform the duties that the law prescribes.

If the intention is indeed to save small private companies the costs associated with the appointment of qualified professionals, a suitable alternative would be to exempt such companies – or even all private companies – from the requirement to appoint a secretary. A leaf can be taken from other jurisdictions in this connection. For example, whilst it is mandatory under UK company law for a public company to have a secretary,<sup>73</sup> all private companies are exempt from this requirement.<sup>74</sup> Such regulatory tiering, it is true, fails to address the risks which the requirement to appoint a company secretary is intended to mitigate. Even so, exempting all private companies from this requirement would better serve the purpose of the new Act, since doing so would make it less costly to maintain private companies.

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72 See s 82(7) of the new Act, as read together with s 3 of the new Act.

73 S 271 of the UK Companies Act.

74 S 270(1) of the UK Companies Act.

This is not to underplay the role of company secretaries in the modern corporation.<sup>75</sup> The fact that the law entrusts company secretaries with the responsibility to ensure corporate compliance is itself a testimony of the significance of the office of the company secretary. A company that hires a qualified secretary could even benefit from the learning curve effect and reduce the per-unit cost of compliance, thereby maximising the scale efficiencies associated with regulatory compliance. A company that cannot afford to employ a qualified secretary on the other hand cannot take advantage of expertise to reduce the per-unit cost of compliance. The resultant competitive disadvantage could thus undermine the purpose of the new Act. Indeed, it is likely to be even more inefficient to require such a company to employ an “incompetent” secretary than to discard the requirement altogether. Such regulatory exemption would allow many entrepreneurs to take advantage of a more flexible regime without necessarily preventing those that can afford to appoint qualified persons from doing so.

## 4 2 Appointment of auditors

A general rule under the new Act is that companies must appoint auditors to audit their annual accounts.<sup>76</sup> The appointment must be made by shareholders by way of an ordinary resolution. It is incumbent upon the board of directors to ensure that auditors are appointed in a timely manner. If a company fails to appoint auditors within 90 days after the end of the company's financial year, every director of the company commits an offence and is liable upon conviction to a fine of up to 100,000 penalty units (i.e. K30,000).<sup>77</sup> The only exception to the general requirement to appoint auditors is that small private companies need not appoint auditors unless under specified circumstances.<sup>78</sup>

More precisely, before or at the time of the company's annual general meeting (AGM), members of a small private company limited by shares are entitled to give notice to the board of directors of their intention to appoint auditors. To be legally valid, any such notice must be signed by shareholders who hold at least 50 per cent of the issued share capital of the company.<sup>79</sup> Where a valid notice has been given, the company must, by way of an ordinary resolution, appoint auditors to audit the company's accounts for the financial year to which the AGM relates and the resolution automatically ceases to have effect at the next AGM.<sup>80</sup> A small private company that invokes the option to appoint auditors is

75 See *Barnett, Hoares & Co v South London Tramway Co* (1887) 18 QBD 815; *George Whitechurch Ltd v Cavanagh* (1902) AC 117; *Ruben v Great Fingall Consolidated* (1906) AC 439. Contrast with *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* (1971) 3 All ER 16.

76 S 253 of the new Act.

77 S 253(4) of the new Act, as read together with Fees and Fines (Fee and Penalty Unit Value) (Amendment) Regulations, reg 2.

78 Ss 253(5) and 263(1) of the new Act.

79 S 264(1) of the new Act.

80 S 264(2) of the new Act.

required to comply with all the provisions of the new Act that govern the appointment of auditors.<sup>81</sup>

The exemption of small private companies from the requirement to appoint auditors could relieve them of the financial (and administrative) burden associated with that requirement. Indeed, the hourly rate of audit fees generally varies according to the seniority of the individual auditors conducting a given audit rather than according to firm size.<sup>82</sup> Thus, even though it might take longer to audit a large company than a small one, the requirement to appoint auditors could be disproportionately burdensome on small companies. By the same token, all things being equal, the marginal social cost of a regulation that requires small companies to audit their annual accounts is likely to be greater than the marginal social benefit. This is more so because small companies are typically characterised by a lack of separation between share ownership and corporate control, thereby reducing the need to conduct audits in small companies.

The right afforded to shareholders of small private companies to demand an audit on the other hand could also serve to protect minority shareholders from accounting fraud in companies where there is at least a partial separation between ownership and control. This appears to be a reasonable means of striking a balance between the need to maximise the benefits of exempting small companies from audit and the need to mitigate the risk posed by that exemption, that is to say, the risk of accounting fraud.

Whether the 50 per cent shareholding threshold required for shareholders to demand an audit is apt to promote controlling shareholder accountability is, however, doubtful. It is worth recalling that most companies in Zambia, not least private companies, have a concentrated ownership structure.<sup>83</sup> Indeed, the shareholding of private companies tends to be concentrated around the world since, by definition, private companies do not publicly trade their shares.<sup>84</sup> The 50 per cent shareholding threshold required for the exercise of the right to demand an audit is therefore likely to enable controlling shareholders, who are also typically directly involved in management, to prevent the exercise of the right.

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81 S 263(2) of the new Act.

82 See Accountants (Client Fees) Regulations SI 34 of 2018.

83 See World Bank "Corporate Governance Country Assessment: Zambia" 2006 <http://hdl.handle.net/10986/8198> (last accessed 2023-05-26). The ownership of listed companies is concentrated among foreign multinationals and the state.

84 See, by contrast, Faccio and Lang "The Ultimate Ownership of Western European Corporations" 2002 *Journal of Financial Economics* 365-379; Gilson "Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy" 2006 *Harvard Law Review* 1643; OECD *Corporate Governance Factbook* (2017) 14.

It is also interesting to note that this threshold is five times higher than the one applicable in the UK. Under the UK Companies Act, like under the new Act, small companies are generally exempt from audit.<sup>85</sup> Nevertheless, members of a small company representing at least ten per cent of the company's issued share capital or any class of it or, if the company does not have share capital, at least ten per cent of the members of the company, are entitled to demand an audit of the company's accounts for a specific financial year.<sup>86</sup> Whatever explanation may be given for this regulatory divergence, it appears that the new Act is somewhat at odds with its own intended purpose insofar as it restricts the right to demand an audit in the manner that it does. Enterprise efficiency may not be achieved without financial accountability.

### 4 3 Bookkeeping and financial reporting requirements

Whilst small private companies are generally exempt from the requirement to audit their accounts, all companies in Zambia regardless of size are required to keep accounting records at the registered office.<sup>87</sup> All companies are also required to prepare annual reports on corporate affairs.<sup>88</sup> An annual report must contain, inter alia, the company's financial statements, and any group financial statements and must be sent to all shareholders at least 21 days before the date fixed for the company's AGM.<sup>89</sup> All annual financial statements must comply with the standards prescribed by the body that regulates the practice of accountancy in Zambia.<sup>90</sup> In short, the new Act does not afford small private companies any special treatment vis-à-vis bookkeeping requirements and the preparation of annual accounts.

It is particularly surprising that small private companies do not enjoy any special treatment under the new Act with respect to the requirement to prepare group accounts. The new Act requires a parent company, regardless of its size or the size of the group that it heads, to prepare consolidated financial statements within six months after the end of its financial year.<sup>91</sup> Any failure to do so is an offence.<sup>92</sup> This means that even a parent company that heads a group that would qualify as small under the new small companies regime is also required to prepare group accounts.

As already noted above, recordkeeping and reporting requirements are a well-known source of economies of scale.<sup>93</sup> This explains why, in

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85 S 475 of the UK Companies Act.

86 S 476 of the UK Companies Act.

87 Ss 246 and 247 of the new Act.

88 S 275 of the new Act.

89 Ss 276 and 277 of the new Act.

90 S 266 of the new Act.

91 S 267 of the new Act.

92 S 252(3) of the new Act.

93 Bradford 2004 *Journal of Small and Emerging Business Law* 9-11.

other jurisdictions, these requirements are normally tiered in favour of small companies. Under the UK Companies Act, for example, a parent company is exempt from the requirement to prepare group accounts if at the end of the financial year that company is either subject to the small companies regime or would be subject to the small companies regime but for being a public company.<sup>94</sup>

Granted, corporate groups give rise to agency problems vis-à-vis the interests of minority shareholders and creditors, where these exist.<sup>95</sup> Group accounting could thus help ameliorate agency problems. Be that as it may, the need for intra-group accountability generally arises only “when there are shareholders who are not on the board – either members of the family or complete outsiders, including venture capitalists.”<sup>96</sup> There is no need for accountability to shareholders in typical small groups where there is no separation between ownership and control. Any need to protect corporate creditors as such does not appear to outweigh the need to relieve such small groups of private companies of the requirement to prepare group accounts as there are other effective ways through which creditor protection can be achieved, including through contractual arrangements.<sup>97</sup>

As concerns financial reporting requirements, the new Act requires public companies to submit audited financial statements to the Registrar of Companies within 30 days of those statements being adopted by the shareholders.<sup>98</sup> Interestingly, the Act does not impose a corresponding requirement on private companies. It would therefore appear that the new Act implicitly exempts all private companies (rather than only those that qualify as small) from the requirement to file annual accounts with the Registrar of Companies. This is in stark contrast to the UK Companies Act which requires private limited companies and public companies alike to prepare and file annual accounts at Companies House. Small companies and micro-entities may, however, prepare an abridged version of those accounts (i.e. a balance sheet that contains a subset of the information that is included in a full balance sheet).<sup>99</sup> The UK

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94 S 399 of the UK Companies Act, as amended by Companies, Partnerships and Groups (Accounts and Reports) Regulations; and Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations SI 1245 of 2016.

95 See generally Böckli et al “A Proposal for the Reform of Group Law in Europe” 2017 *European Business Organization Law Review* 1; Hopt “Groups of Companies – A Comparative Study on the Economics, Law and Regulation of Corporate Groups” 2015 <http://ssrn.com/abstract=2560935> (last accessed 2023-05-26).

96 Charkham *Keeping Better Company: Corporate Governance Ten Years On* (2008) 361.

97 Armour, Hertig and Kanda “Transactions with Creditors” in Kraakman et al (eds) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2017) 109.

98 S 265(2) of the new Act.

99 S 444 of the UK Companies Act, as amended by Companies, Partnerships and Groups (Accounts and Reports) Regulations; and Small Companies (Micro-Entities’ Accounts) Regulations.

Companies Act also exempts small companies from the requirement to file the director's report and profit and loss account. Small companies can choose whether or not to file these documents.

As noted above, tiering by exemption completely removes the regulatory burden to the extent of the exemption, whereas tiering by imposing lighter regulatory requirements merely lightens the burden. Thus, exempting private companies from financial reporting obligations as does the new Act might appear to be more favourable to private companies, including those that qualify as small, than requiring them to file at least abridged accounts as does the UK Companies Act. It is worth recalling, however, that financial reporting regulation could influence company performance both directly, by imposing the burden to file accounts with the Registrar, and indirectly, by shaping stakeholder provision of vital resources and market opportunities as a response to the accessibility of the company's financial information. Empirical evidence from the UK suggests that small companies themselves prefer filing abridged (formerly "abbreviated") accounts to full accounts mainly in order to limit public disclosure of information that stakeholders might use to harm them rather than in order to avoid the direct administrative burden associated with financial reporting.<sup>100</sup> In particular, if the filed accounts disclose substantial profits, competitors might be attracted to the market, "suppliers might raise prices, employees might seek higher salaries, and customers might seek discounts in order to capture a greater share of the value that the company creates."<sup>101</sup>

By the same token, most stakeholders prefer full disclosure or at least partial disclosure to no disclosure at all. Whilst stakeholders may differ in terms of their capacity to access financial information privately, published accounts often constitute the starting point for an enquiry into the creditworthiness of a company (for example, when choosing a new supplier or customer, to find out about competitors or to consider an acquisition), thereby influencing the decision to continue or discontinue the information search.<sup>102</sup> Thus, regulation mandating full disclosure "might encourage stakeholders to act in ways that enhance rather than constrain performance by motivating customers to do business,

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100 Collis and Jarvis "How Owner-Managers Use Accounts" 2000 <https://www.icaew.com/-/media/corporate/files/technical/research-and-academics/publications-and-projects/financial-reporting-publications/how-owner-managers-use-accounts.ashx> (last accessed 2023-05-26); Professional Oversight Board for Accountancy "Review of How Accountants Support the Needs of Small and Medium-Sized Companies and their Stakeholders" 2006 <https://www.frc.org.uk/getattachment/121e3bd1-aef7-4b46-977b-f7057b8c0216/Final-POBA-Review-of-how-accountants.pdf> (last accessed 2023-05-26); Kitching, Kašperová and Collis "The Contradictory Consequences of Regulation: The Influence of Filing Abbreviated Accounts on UK Small Company Performance" 2015 *International Small Business Journal* 671.

101 Kitching, Kašperová and Collis 2015 *International Small Business Journal* 679.

102 Kitching, Kašperová and Collis 2015 *International Small Business Journal* 680.

suppliers to offer credit, credit reference agencies to award higher ratings and trade credit insurers to provide cover to policyholders trading with small companies.”<sup>103</sup>

Whether the constraining effects on business performance of financial reporting obligations outweigh the enabling effects is an empirical question. One empirical study suggests that regulation requiring small companies to make limited financial disclosure might indirectly constrain performance more than laws mandating increased or full disclosure.<sup>104</sup> In any event, it is incumbent upon policymakers to strike a reasonable balance between the need to mitigate the constraining effects on business performance of extensive financial reporting and the need to maximise its enabling effects. It would therefore appear that exempting companies from financial reporting obligations altogether, as does the new Act, is an inefficient policy choice. It is detrimental to private companies, including those that qualify as small, as stakeholders are likely to withhold valuable resources and market opportunities from those companies, preferring public companies which are required to make full financial disclosure.

## 5 Conclusion

The preamble to the new Companies Act is crafted with a promising flair. But the devil is in the details. Not only is the new Act laden with apparent drafting errors but it is also imbued with apparent substantive deficiencies. The Act could benefit from a comprehensive review. This article seeks only to prompt further discourse by highlighting some examples of the provisions which could be considered for amendment. The article focuses on the small companies regime that the new Act introduces. It highlights some of the deficiencies of that regime that could undermine the very purpose of the new Act, namely that of promoting the development of Zambia’s economy through efficient regulation of companies. This purpose cannot be achieved without efficient regulation of small companies. As a category of SMEs, small companies create the majority of new jobs, are a vital source of market competition, and play a central role in undertaking and spreading productivity-enhancing innovations in the economy.<sup>105</sup> The need to revise the new small companies’ regime as suggested in this article cannot, therefore, be overemphasised.

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103 Kitching, Kašperová and Collis 2015 *International Small Business Journal* 675.

104 As above.

105 International Trade Centre 2019; Centre for Economics and Business 2019.