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MBA THESIS

"A STUDY ON THE CORPORATE GOVERNANCE FRAMEWORK IN PAKISTAN"

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Executive Summary

"A recent World Bank study on South Asia "Access to Finance" ranked Pakistan corporate governance standards highest among South Asia. This is further supplemented by the 2005 ROSC assessment of corporate governance standards which have given higher points, relative to the world average, to Pakistan on majority of its principles. Among other efforts, this is an outcome of effectiveness of an elaborate Corporate Governance Framework laying down specific corporate governance guidelines for the corporate sector"[1].

This eloquent statement made by the head of the Country's Central Bank at an international forum is a sure acknowledgment of the efforts done so far towards the development of corporate governance framework in Pakistan. Given the recent corporate failures -- such as Enron and WorldCom in the United States, Harris Scarfe, One-Tel, HIH and Ansett in Australia, Parmalat in Italy and Ahold in the Netherlands -- as well as the Asian crisis, there has been a conscious effort to strengthen corporate governance practices not only in the developed world, but also in the developing world.

In a similar vein, actors on the Pakistani capital market have also started to understand the significance of well-functioning corporate governance mechanisms. Recent corporate scams such as those involving financial cooperatives and forex companies have alarmed the corporate community and public policymakers alike to take corporate governance seriously. The public and private sectors are now aware that the availability of outside funding can no longer be guaranteed unless certain corporate governance standards are adopted and enforced. The increasing globalization further underscores the importance of corporate governance reforms. Weak investor protection in Pakistan has negatively affected overseas financing and domestic savings. Further, research studies done all over the world have shown that foreign direct investment (FDI) into a country's corporate sector is bolstered in

[1] Excerpt from Dr. Shamshad Akhtar, Governor State Bank of Pakistan's key note address at Institute of International Bankers Annual Washington Conference, Washington DC, USA on 5 March 2007 (Business Recorder, March 19 2007)

the presence of a sound and effective corporate governance framework, leading to national economic growth[2].

This thesis study brings forth the conclusion that with the adoption of the Corporate Governance Code, there has been improvement in the overall corporate structure and business environment by making the companies more responsible, and by ensuring transparency and accountability in the corporate and financial reporting framework. Several research studies have also shown that most of the listed companies have started implementing the provisions of the Corporate Governance Code. The inclusion of non-executive directors on the board is a big step forward as it will discourage the tendency of protecting personnel interests and motives at the expense of the minority shareholders. Moreover, the addition of the non-executive members has improved decision-making process, which was not only slow previously, but also opaque due to the lack of interest of the board of directors to meet as and when required. The publication of the quarterly results and better disclosure of material information has also resulted in best price discovery of shares, which is a vital requirement for the investors operating in the modern corporate environment.

However, all of these positive developments must be viewed with caution, as another major observation out of this thesis study is that the introduction of the Code and all other corporate governance initiatives though has made the corporate managements quite conscious of their corporate and fiduciary responsibilities, but they have been accepted only in form and not in substance. It has been observed that some of the companies are still violating the laws for disclosing the material information and are manipulating the announcements of the results for the benefits of the insiders. Similarly family oriented businesses/groups still view corporate governance requirements as obstacles and are trying to resist them though subtly. Here there can be no denying of the fact that regulation matters for good corporate governance. The impediments identified and discussed in this thesis study, call upon the regulators to improve the enforcement mechanisms across the board in an efficient and effective manner. A lot depends upon the regulators as at this critical 2nd stage, the capacity of corporate entities to fully comply with the corporate governance is somewhat limited. The policy makers should look into their problems and

[2] UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad.

provide them with the means to enhance their capacity and understanding about best practices on corporate governance.

The experience of several developed and developing countries clearly reflect that the required action at this stage in development of corporate governance framework should be the establishment of transparent and accountable systems of public policy and governance and enhanced capacity of regulators for Regulatory Impact Assessment of CG standards in the country[3]. It is the task of the men at the helm to introduce relevant changes in our regulatory structures to make them more compatible with international norms and standards. There has already been a sea change in the regulatory apparatus of the country. However we need more such positive actions in letter and spirit, to further strengthen & ensure the effectiveness of corporate governance framework in Pakistan for a long time to come.

[3] Rais, Rasul Bakhsh and Asif Saeed (2005)

"A STUDY ON THE CORPORATE GOVERNANCE FRAMEWORK IN PAKISTAN"

1. Introduction

1.1. Introduction

Corporate governance has succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations and society in general. In the past, this has often been limited to the question of improving financial performance, for example, how the corporate owners can secure/motivate that the corporate managers will deliver a competitive rate of return. But the fact that this is a vast field is made obvious by the growing amount of research on this topic.

1.2. Significance of the Project Study

In recent years, Corporate Governance has been a popular field of interest in Pakistan. In this respect, SECP and Other regulatory institutions have taken a number of steps in the last five years to streamline the prevalent issues in corporate governance in the Corporate Sector. Generally it was expected that introduction of code of corporate governance will ensure greater transparency in the corporate sector through improved financial reporting and disclosure standards.

The 1st code of corporate governance was introduced in Pakistan by Securities and Exchange Commission of Pakistan (SECP) in March 2002[4]. Since its introduction, the corporate sector of Pakistan has whole heartedly embraced the code of corporate governance along side which, the chief regulator, SECP has also taken a number of steps to effectively raise the level of its implementation. This Thesis research report is a study on the improvements and level of implementation of corporate governance framework in Pakistan.

4 Securities and Exchange Commission of Pakistan (2002). Code of Corporate Governance 2002. Islamabad.

1.3. Conceptual Framework of the Study

With this central premise in mind, we have outlined following research questions/objectives as focus of this thesis study;

- Studying the level of implementation of Code of Corporate Governance in Pakistan.
- Looking at the evolution of the state of corporate governance in Pakistan.
- Examining the role of SECP in creating stakeholder awareness on the issue of corporate governance
- Determining the assessment of the impact of Code of corporate governance amongst Pakistani corporate sector.

The proposed research plan involved discussing the above-mentioned issues with the help of official publications of SECP, SBP and research and working papers published on topics of corporate governance such as their annual reports etc. A sincere effort has been made to give due reference whenever material from any source is cited. Any mistake however is purely unintentional and regretted. A complete list of publications & research papers consulted is found in the Bibliography section of this thesis study.

2. Literature Review

2.1 Accountability

The liability of a board of directors to shareholders and stakeholders for corporate performance and actions is known as accountability. *"Accountability"* describes the Board of director's duty to shareholders. In particular, the Board of directors has a special duty and responsibility to develop the company's strategic vision, ensuring the enhancement of long-term share values. In doing so, the Board and management should be open and accessible to inquiry by shareholders and other stakeholders about the condition and performance of the company and should disclose how key decisions were made, including those that affect executive compensation, strategic planning, nomination and appointment of directors and appointment and succession of managers and financial controls.

2.2 Agency Problem

The agency problems arise from the divergent interest groups amongst the corporation stakeholders, including the shareholders (Principals) and management/employees (Agents). *"Agency problems"* are a consequence of the separation of ownership and management in publicly owned corporations. As the ownership of corporations is widely dispersed, management of the corporation is that were a consequence of the separation of ownership and management in publicly owned corporations. As the ownership of corporations is widely dispersed; management of the corporation is *"agency problems"*

From this stems the theory that the interest of the shareholder is not determined or protected by any formal instrument, unlike the interest of most stakeholders and investors which can generally and adequately be protected through contractual rights and obligations with the company. It is, for this reason, that corporate governance is primarily directed at the effective protection of shareholder interests.

2.3 Annual General Meeting (AGM)

A company gathering, usually held at the end of each financial year, at which shareholders and management discuss the previous year and the outlook for the future, directors are elected and other shareholder concerns are addressed.

2.4 Audit Report

Statement of the accounting firm's assessment of the validity and accuracy of a company's financial information and conformity with accepted accounting practices.

2.5 Board of Directors

The collective group of individuals elected by the shareholders of a corporation to oversee the management of the corporation on their behalf.

2.6 Code of Corporate Governance

The Code is a compilation of “best practices”, designed to provide a framework by which companies listed on Pakistan's stock exchanges are to be directed and controlled with the objective of safeguarding the interests of stakeholders and promoting market confidence; in other words to enhance the *performance* and ensure *conformance* of companies. The Code is a first step in the systematic implementation of principles of good corporate governance in Pakistan.

2.7 Companies Ordinance 1984

The main statutory law in form of an ordinance which contains all relevant laws & by-laws relating to the formation, functioning and management of companies and certain other associations for the purpose of healthy growth of the corporate enterprises, protection of investors and creditors, promotion of investment and development of economy.

2.8 Compliance with Corporate Governance

The declaration by a company that the company has published and circulated a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance. All companies also declare that the company has ensured that the statement of compliance with the best practices of corporate governance is reviewed and certified by statutory auditors, where such compliance can be objectively verified, before publication by listed company.

2.9 Collusion between BOD & Management

A common feature of family dominated corporations is a certain degree of collusion between the BODs and management. This collusion arises because family as a unit calls the shots and controls both the BOD and management of the company. As a result, there are limitations to using the BOD as a body that is accountable to all shareholders.

2.10 Concentrated Control

In the local listed companies, the dominance of the family as a controlling unit is apparent as the family unit controls half of the equity of an average listed textile company either through direct ownership or by virtue of ownership through associated companies. Apart from textiles, other sectors are also characterized by family dominance where the family directly or indirectly controls approximately one third of the equity of an average company.

A family can control shares in a target company either by owning shares or indirectly through associated companies, which are under their control. By retaining decision making control over capital that has been invested by external investors (banks and minority shareholders), the controller (a family-based owner manager in the case of Pakistani listed local companies) exercises and enjoys considerable discretion over the use and allocation of external investors capital. Concentrated control is a salient characteristic of Pakistani corporate governance and this feature has a number of consequences for the development of the corporate sector and capital markets in the country. This characteristic is discussed in detail later in this report.

2.11 Conflict of interest

When someone is in a position of trust which requires them to exercise judgment on behalf of others and also has interests of the sort that might interfere with the exercise of their judgment, and which the person is ethically required to either eschew or openly attest.

2.12 Corporate & Financial Disclosure Framework

The framework under which all companies need to declare that quarterly un-audited financial statements/ accounts are circulated to the shareholders after approval by the Board of Directors within 30 days. Similarly, all companies averred that half yearly accounts are subjected to a limited scope review before approval by the Board of Directors and circulated to the shareholders.

2.13 Corporate Governance

The term corporate governance refers to the rules and incentives by which the management of a company is directed and controlled so as to maximize the profitability and long-term value of the firm for its shareholders while into account the interests of other legitimate stakeholders (Stone et al, 1998). The main players involved in corporate governance are directors, stakeholders and management. Corporate governance promotes transparency and accountability within corporate entity

2.14 Disclosure

The public dissemination of material, market-influencing information.

2.15 Equity Contract

The corporate governance system specifies the rights of the shareholder and the steps available if management breaches its responsibilities established on equitable principles from this springs the "*equity contract*". The inability or unwillingness to make credible disclosure constitutes a bad equity contract which potentially makes it difficult for the market to distinguish good risk from bad resulting in an inability to attract investors.

2.16 Executive Director

A member of a company's board of directors who is also an employee of the company.

2.17 Expropriation Problem

A distinctive characteristic of the Pakistani corporate culture, however, is the pyramidal ownership structure and corporations with concentrated ownership enabling large shareholders to directly control managers and corporate assets. Thus the need for corporate governance should not, perhaps, arise under the prevailing structure as the conflict of interest that emerges gives rise to the *"expropriation problem"* as opposed to the *"agency problem"*

2.18 Fair disclosure

The release of all material, market-influencing information to the public at the same time.

2.19 Fiduciary Responsibility

Since a company is an artificial legal person, it needs individuals, i.e. directors who can act for it, represent it and make decisions concerning how it is to be run. Directors are, in short, responsible for the proper running and management of the company. This responsibility is fiduciary in nature.

This responsibility of Directors and management to act in good faith, trust, confidence, candor (Blacks Law Dictionary) as they have been vested with the authority to act on behalf of the stakeholders. The corporate governance framework should recognize the rights of stakeholders as established by law. It should also encourage fair practices on part of the board of directors and encourage them to promote the objectives of the company. In doing so, the directors should ensure the following.

- They must act in good faith;
- They must act for a proper purpose, i.e. in pursuance of objectives that are in the interests of the company;
- They must not fetter their discretion; and
- They must not place themselves in a position of conflicting interests.

2.20 ICAP-Institute of Cost Accountants of Pakistan

Institute of Chartered Accountants of Pakistan (the ICAP) took the initiative to develop a framework of good governance in Pakistan. A committee representing the SEC, ICAP, the Institute of Cost and Management Accountants of Pakistan and the stock exchanges was established. A subcommittee was formed to undertake the task of formulating recommendations for drawing up a draft code of corporate governance.

2.21 Impact Assessment Study of Code of Corporate Governance

An UNDP-SECP publication that assesses the extent and effect of implementation of the Code of Corporate Governance amongst companies. A Survey questionnaire approach was used in this analytical study[5].

2.22 Independent director

A director who is not connected with the listed company or it promoters or directors on the basis of family relationship and who does not have any other relationship whether pecuniary or otherwise with the listed company, its associated companies, directors, executives or related parties.

2.23 Internal Audit

An evaluation of a company's financial health by its own employees is known as Internal Audit.

2.24 Institutional Investor

Institutional investors include financial institutions (both banks and non-bank financial companies) and non-financial companies. These include both the public-owned as well as privately owned institutions.

2.25 Manual of Corporate Governance

In Pakistan, The SECP and AZ Zaman Advocates and Legal Consultants, a corporate law firm, developed a Manual of Corporate Governance. This comprehensive document discusses various key issues on the topic. Beginning with an analysis of the definitions of corporate governance, the Manual examines the need for corporate governance, the role of stakeholders, responsibilities of directors and senior management as well as how to scrutinize financial statements. The aim behind the manual is to be used as a reference on different aspects of corporate governance.

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2.26 Minority Director

Those representing minority interests on the Board of directors.

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[5] The Questionnaire & survey findings are attached as Annex D & E respectively.

2.27 Minority Shareholder

Shareholders who have minority interests in the corporation hence no say in the running of the company's affairs.

2.28 McKinsey & Company' Global Investor Survey

A July 2002 McKinsey and Company global investor survey brought forward the result that "more than 60% of investors state that governance considerations might lead them to avoid individual companies with poor governance." McKinsey & Company is a management consulting firm advising companies and institutions on issues of strategy, organization, technology, and operations[6].

2.29 Non-executive director

A person elected by shareholders to a corporation's board of directors who is not affiliated with the company in any other capacity.

2.30 Securities & Exchange Commission of Pakistan (SECP)

The Securities and Exchange Commission of Pakistan (SECP) was set up in pursuance of the Securities and Exchange Commission of Pakistan Act, 1997. This Act institutionalized certain policy decisions relating to the constitution and structure, powers, and functions of the SECP, thereby giving it administrative authority and financial independence in carrying out its regulatory and statutory responsibilities.

The SECP became operational in January 1999 and has come a long way since then. It was initially concerned with the regulation of corporate sector and capital market. Over time, its mandate has expanded to include supervision and regulation of insurance companies, non-banking finance companies and private pensions. The SECP has also been entrusted with oversight of various external service providers to the corporate and financial sectors, including chartered accountants, credit rating agencies, corporate secretaries, brokers, surveyors etc. The challenge for the SECP has amplified manifold with its increased mandate.

[6] UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad (retrieved from SECP's website Oct 2006).

2.31 Shareholder

A person or entity that owns shares of stock in a corporation or mutual fund.

2.32 Stakeholder

Any group, individual or institution that has an interest in a company

2.33 Statement of Compliance with best practices/Code of Corporate Governance

A Statement of compliance is a declaration that the company has published and circulated a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance. All companies also declare that the company has ensured that the statement of compliance with the best practices of corporate governance is reviewed and certified by statutory auditors, where such compliance can be objectively verified, before publication by listed company.

2.34 Statement of Ethics & Business Practices

The Code requires that a statement of ethics and business practices must be prepared and circulated annually by the Board of directors of every listed company to establish a standard of conduct for directors and employees. All employees have some responsibility for implementation of effective internal control procedures as part of their accountability for achieving objectives. They collectively should have the necessary knowledge, skills, information and authority to operate the company. This will require an understanding of the company, its objectives, the industries and markets in which it operates, and the risks it faces. Their endeavors towards these requirements will contribute positively to the performance of the company and success will ensure job stability and satisfaction. A secure work environment and one that protects and safeguards the rights of employees is a means by which to attain optimum levels of performance. A statement of ethics and business practices covers all such areas.

2.35 Transparency

An environment allowing open communication between stakeholders, investors and company managers and all material information is readily available to the public.

"Transparency" can be achieved through three key market elements: openness, accounting standards, and compliance reporting.

2.36 The Foundations of Corporate Governance (FCG):

The Foundations of Corporate Governance is a research and educational initiative on corporate governance in Pakistan started by Lahore University of Management Sciences (LUMS) and supported by a grant from Citigroup Foundation, New York. The Main aims of this project are to assist key stakeholders in Pakistan include;

- Developing systematic plan of action to rebuild investor's confidence
- Creating corporate standards
- Transferring CG practices within and across industries
- Increasing public sector discipline

The Foundations of Corporate Governance is also known as the CG Initiative. Since launch, CG Initiative has been holding a variety of activities like seminars and annual conferences on corporate governance. This int6iative also invites working papers on corporate governance issues and practices. A web portal of this initiative is maintained and is accessible though LUMS Website[7]. This CG initiative is being run under the auspices of Centre for Management and Economic Research (CMER), LUMS. CMER is a research centre of the Lahore University of Management Sciences, which was founded in 1992 with initial funding from CIDA through the LUMS-McGill Linkage Project. Extensive help and reference material for this thesis study is taken from CG Initiative and CMER's web portal.

[7] Http://www/cmer.lums.edu.pk (Information retrieved February 2007)

Literature Review of Research & Working Papers:

- **Bari, F. Cheema, A. & Osama Siddique (2003). Corporate Governance in Pakistan: Ownership, Control and the Law[8].**

Corporate governance (CG) reform has dominated policy agendas in both developed and developing countries during the nineties. Policy making interest in CG gained momentum in the wake of the East Asian financial crisis and as a result of scandalous revelations about corporate practices in leading U.S corporates like Enron. Governments, stock exchanges and business associations across the world are competing to produce CG guidelines. These reforms are thought to be of great significance for developing countries that are making a sustained effort to attract Foreign Direct Investment (FDI) and to mobilize greater savings through capital markets.

In this research paper, Cheema et all (2003) present the thought that CG reforms initiated during the last few years, by the Securities and Exchange Commission of Pakistan (SECP), argued to be an important component of the Government of Pakistan's (GoP) growth revival strategy are mildly successful in formulating CG standards in the country. They argue that this recent concern for growth revival in Pakistan is underscored by the extent of the growth slowdown during the last decade. Further, the authors identify the main barriers faced in way of CG reforms, i.e. Ownership & Control patterns of Pakistani Corporates. This paper was first presented in 2003 at a conference on Corporate Governance held in Bangladesh.

- **Chaudary, Faiza A., Goergen, Marc and Shoeb I. Syed (2006). Corporate Governance in the Financial Sector of Pakistan CMER Working Paper # 06-50**

La Porta et al. (1998) assigned Pakistan, a common-law country, the maximum score of 5 for their anti-director rights index. Pakistan should therefore be a country with good investor protection attracting large amounts of investments. Authors tried to authenticate this hypothesis in this research paper. What they found was that the reality could not be more different. Pakistan has been lagging behind other, comparable Asian economies in terms of incoming foreign direct investment as well as GDP-per-capita growth. This paper

[8] Two of the authors, Dr. Ali Cheema and Osama Siddique (2003) are associated with LUMS as assistant professors.

focuses on the Pakistani banking sector. The paper analyses the banks' ownership and control structure. It finds that Pakistan has its own idiosyncrasies, which are difficult to associate with La Porta et al.'s characterization of corporate governance and in*vestor protection* in common-law countries. The paper also reviews the recent reforms of corporate governance.

- **Ghani, Waqar I. and Junaid Ashraf (2005). Corporate Governance, Business Group Affiliation, and Firm Performance: Descriptive Evidence from Pakistan CMER Working Paper # 05-35**

This study examines business groups and their impact on corporate governance in Pakistan. The authors have used non-financial firms listed on the Karachi Stock Exchange of Pakistan for 1998-2002 periods in order to select group and non-group samples. Their analysis find that group firms have higher liquidity/short-term debt paying ability, and lower financial leverage than those of the non-group firms in each of the five years and when averaged over five-years. More importantly, they find that for the group firms, the five-year mean values of revenues and the five-year mean values of total assets grew faster than those of the non-group firms. Based on mean values of ROA, they find that group firms are more profitable than non-group firms in each year and over all five-years combined.

In contrast, Tobin's Q results (a market valuation measure) show that the mean values for each year and for all five-years combined are lower than those of the non-group firms. The divergence between ROA and Tobin's Q suggests that external shareholders perceive firms affiliated with business groups to have relatively lower transparency and weaker corporate governance mechanisms than firms not affiliated with business groups. As a consequence, the market participants appear to discount the value of group firms even though these firms are more profitable than non-group firms. They interpret this evidence to indicate that investors view the business-group as a mechanism to expropriate minority shareholders. On the other hand, the comparative financial performance results suggest that business groups in Pakistan are efficient economic arrangements that substitute for missing or inefficient outside institutions and markets. Authors feel that their preliminary work substantially contributes to our understanding of business groups and their relationship to corporate governance and economic development in Pakistan.

- **Corporate Governance in Pakistan - Adopt or Adapt? By Mahwesh Mumtaz (University of Cambridge Research)[9]**

This study discusses the implications for Pakistan, as it adopts the Anglo-Saxon model of corporate governance. It explores the causes of impediments that policymakers face as they try to implement the Code of Corporate Governance. The empirical question that the study poses is whether a Corporate Governance model that works for the US and the UK, also work for a country like Pakistan? Data and literature review of this study show that Pakistan is a country much further down on the development ladder, with ownership structures markedly different from the diluted ownership structures of developed countries; with its stock exchanges displaying shallowness; and its cultural underpinnings heavily influencing how the corporate sector operates. It is concluded that the ultimate objective of the Code of Corporate Governance should be to incorporate good governance into the Pakistani corporate environment, in order to enhance productivity and efficiency, rather than trying to emulate the dynamics of those countries which pioneered the Anglo-Saxon model. It is argued that the Code for Corporate Governance adopted by Pakistan will need to be adapted keeping the local business environment and market conditions in mind. The study proposes a broader paradigm that views the governance problem as more than mere conflict of interest between owners and managers or minority and majority shareholders, in order to be able to devise better policies that are tailored to the unique corporate context of Pakistan.

- **Rais, Rasul Bakhsh and Asif Saeed (2005). Regulatory Impact Assessment of SECP's Corporate Governance Code in Pakistan CMER Working Paper # 05-39**

This paper attempts to analyze the Corporate Governance Code 2002 in the light of Regulatory Impact Assessment (RIA) framework and its enforcement and application in Pakistan in order to understand the dynamics of public decision making and assess the efficacy of the regulation policy of SECP in the arena of corporate governance. The main objective of this paper is to study the method of framing the Corporate Governance Code 2002 and assess its effectiveness as well as its compatibility with

[9] Corporate Governance in Pakistan - Adopt or Adapt? By Mahwesh Mumtaz (University of Cambridge Research)

international norms and guidelines. It uses RIA approach, which is being increasingly applied in both the developed and developing countries, in order to explain the process of assessing costs and benefits of a new or an existing regulation. In doing this, authors have used two types of questionnaires. The first type of questionnaire was used for the structured interviews with the key stakeholders for critically reviewing the process of formulating the Code. The second type of questionnaire was used to assess the extent and degree of implementation of the Code on the listed companies. The analysis shows that though the listed companies are gearing themselves up to adopt the Code, there are some constraints, and reservations about the way it was drafted and implemented. The paper concludes that the policy makers should try to apply RIA framework more rigorously for ensuring greater accountability of the regulatory actions as well as improving regulatory transparency.

3. SECP: An Introduction to the Corporate Sector Regulator

3.1 Inception & Objectives

The Securities and Exchange Commission of Pakistan (SECP) was set up in pursuance of the Securities and Exchange Commission of Pakistan Act, 1997. This Act institutionalized certain policy decisions relating to the constitution and structure, powers, and functions of the SECP, thereby giving it administrative authority and financial independence in carrying out its regulatory and statutory responsibilities.

The SECP became operational in January 1999 and has come a long way since then. It was initially concerned with the regulation of corporate sector and capital market. Over time, its mandate has expanded to include supervision and regulation of insurance companies, non-banking finance companies and private pensions. The SECP has also been entrusted with oversight of various external service providers to the corporate and financial sectors, including chartered accountants, credit rating agencies, corporate secretaries, brokers, surveyors etc. In recent years, the challenge for the SECP has amplified manifold with its increased mandate.

Vision

"The development of modern and efficient corporate sector and capital markets based on sound regulatory principles, that provides impetus for high economic growth and foster social harmony in the Country."

Mission

"To develop a fair, efficient and transparent regulatory framework, based on international legal standards and best practices, for the protection of investors and mitigation of systemic risk aimed at fostering growth of a robust corporate sector and broad based capital market in Pakistan."

Strategy

"To develop an efficient and dynamic regulatory body that fosters principles of good governance in the corporate sector, ensures proper risk management procedures in the capital market, and protects investors through responsive policy measures and effective enforcement practices."[10]

3.2 Organization Structure & Policy Board of SECP:

To ensure full autonomy of the Commission, the 1997 Act provides for establishment of a Securities and Exchange Policy Board (Policy Board). The main objective of the

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[10] SECP Annual Report, 2006

Policy Board is to provide guidance to the Commission in all matters relating to its functions and to formulate policies in consultation with the Commission. The Policy Board is also responsible for advising the Government on matters falling within the purview of the Act and other corporate laws; and also to express its opinion on policy matters referred to it by the Government or the Commission[11].

According to the Act, the Policy Board should consist of a maximum of nine members appointed by the Federal Government, including five ex-officio members and four from the private sector. The ex-officio members are: (i) Secretary, Finance Division; (ii) Secretary, Law and Justice Division; (iii) Secretary, Commerce Division; (iv) Chairman of the Commission; and (v) a Deputy Governor of the State Bank of Pakistan (SBP).

For SECP's Organogram, see Annex A.

3.3 SECP & Corporate Governance Framework in Pakistan:

The SECP is committed to improving the corporate governance framework in Pakistan. Since its inception, its leadership has formulated a comprehensive strategy that for enhancing good governance in the country and launched several initiatives to establish and foster a corporate governance framework in Pakistan. SECP's main aim has been to introduce and encourage compliance with good corporate governance practices in order to regain investors' confidence that is critical for sustainable economic growth, which in long run will lead to poverty alleviation.

The SECP identified the following four aspects as the key determinants for bringing about improvement in the corporate governance framework[12]:

- Implementation of the Code of Corporate Governance
- Creating Stakeholder Awareness
- Capacity Building of the SECP
- Networking with Other markets

3.4 Important Achievements of SECP with regard to Corporate Governance

[11] Ibid

[12] Securities and Exchange Commission of Pakistan (2002). *Code of Corporate Governance 2002*. Islamabad.

Following are some of the most important initiatives undertaken by the SECP in the development of Corporate Governance framework in Pakistan.

3.4.1 Establishment of Corporate Governance Cell:

A Corporate Governance Cell has been established at the SEC as a research and resource centre. This unit is involved in policy-oriented research, creating awareness on corporate governance in Pakistan, issuing publications on the topic, and undertaking groundwork for a corporate governance index. The Cell is comprised of two officers who work under the supervision and direction of the Project Manager and the Project Director. The Research Officer is responsible for conducting studies into various aspects of corporate governance with specific reference to Pakistan. The External Communications Officer prepares brochures and guidelines regarding key corporate governance issues as well as organizes seminars and workshops to create awareness about corporate governance. Most SECP publications on Corporate Governance have been undertaken by this cell[13].

3.4.2 Short Term Research Studies:

SECP has been instrumental in initiating a range of short-term consultancy assignment on Corporate Governance. Such studies were undertaken for research and analysis into the areas of:

1 - The Harmonization of Corporate Laws;

2 - An Evaluation of the State of Corporate Governance in Pakistan

3 - Assessment of the Impact of the Code of Corporate Governance;

4 - A Feasibility Study for the **Institute of Corporate Governance** in Pakistan.

5 - Harmonization of Corporate Laws

6 -Role of Institutional Shareholders in the Promotion of Corporate Governance

3.4.3 Workshops & Seminars on Corporate Governance[14]:

[13] A Complete list of SECP Publications on CG is attached as Annex B

[14] UNDP (United National Development Program) (2003), “Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad.

Four workshops were held in major cities of Pakistan under SECP-UNDP Project on Corporate Governance. These workshops were organized in collaboration with a corporate law firm, Al Zaman Advocates and Legal Consultants to inform the corporate community about various issues in corporate governance. The first three workshops dealt with "The Responsibilities of Directors and Management of Listed Companies" while the final event explored the "Significant Issues in Corporate Governance". They enabled participants to hear from senior representatives of leading local companies on the issue, gain an international perspective from foreign speakers, as well as learn about the regulatory perspective from the SEC. The participants greatly appreciated the efforts of the Project in arranging the events and acknowledged the usefulness of such forums for dialogue and interaction.

1st Workshop: Responsibilities of Directors and Management of Listed Companies
2nd Workshop: Significant Issues in Corporate Governance
3rd Workshop: Strengthening Corporate Governance in Pakistan
4th Workshop: Corporate Social Responsibility

3.5 SECP's Future Initiatives on CG*:*

The regulatory capacity of the SEC needs to be further strengthened for efficient enforcement of good corporate governance practices in Pakistan. In this regard, the most important need is to provide learning opportunities to the SEC officers to enhance their understanding of key governance issues, familiarize them with latest international developments and augment their regulatory and enforcement capabilities. Appropriate and suitably experienced personnel are also needed to be recruited to work with corporate entities on corporate governance issues.

3.5.1 Corporate Governance Index

Corporate governance index is a tool to enable the stakeholders in gauging the state of corporate governance in individual companies and, overall, in a country. It indicates assessment of corporate governance practices and policies and reflects the relative level to which a company follows the generally accepted codes of corporate governance. Governance practices are measured through a survey of each company. Based on the survey findings an index is formulated. The purpose will be to benchmark a company's investor right protection, disclosure quality, board effectiveness and other key features against the principles of transparency, accountability and responsibility. Different aspects of corporate governance included in the index, are such as board of directors, non-executive directors, board committees, internal audit, financial transparency and information disclosure, and stakeholders' rights. The Corporate Governance Cell of SECP is developing the methodology for formulating a corporate governance index for Pakistan. Once completed, this methodology will serve as a foundation to commence research and formulation of the index[15].

3.5.2 Electronic Resource Centre

Originally an electronic resource center was created and maintained by the Corporate Governance Cell to broaden awareness on corporate governance. The resource center houses articles and information related to various aspects of corporate governance. It is regularly updated with the latest information on corporate governance developments and is accessible through the SECP website. However this portal is currently open to users internally at the SECP, the officials at SECP say that plans are in offing to make this resource center to the public at large in the near future[16].

3.6 Regulator's Performance: A Critical Comment

Over the last few years, the Securities and Exchange Commission of Pakistan (SECP) has undertaken various regulatory reforms to improve transparency in the capital market and the corporate sector to engender investor confidence. Corporate governance has been major area of reform, with wide ranging steps taken to improve the overall standard of business practices and governance framework. Though, SECP remains committed to improving the corporate governance framework in Pakistan but still there is a lot needed to be done.

However, it is important to understand that corporate governance is still a relatively new term in Pakistan. Corporate governance entails a whole set of rules and standards, which govern the relationship between a company's directors, management, its shareholders and other stakeholders, which in turn cultivate the key elements of corporate governance framework i.e. transparency, accountability and disclosure. This

[15] UNDP (United National Development Program) (2003), “Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad.
[16] News Release at SECP Website (Information retrieved September 2006)

may take some time in taking its roots in Pakistani corporate culture. But nonetheless, keeping in view the significance of good governance practices, both from micro- and macro-economic perspectives, we can say that the SECP has been reasonably successful in developing corporate governance framework in Pakistan. A measure of this success can been seen from the fact that the Code of Corporate Governance for Pakistan was introduced in March 2002, and was subsequently incorporated in the listing regulations of all the three stock exchanges in the country within a very short period.

4. Corporate Governance: The Concept & Dynamics

4.1 Concept of Corporate Governance

There is no universally accepted definition of corporate governance. It is a concept that is understood by many as being a set of relationships between a company's management, its shareholders and the society within an institutional framework. These relationships evolve into the corporate governance framework, which forms "the system by which companies are directed and controlled".

The relationships among the participants of the governance system and the role played by each participant vary from company to company. It is essential to recognize that every company operates within a 'unique' jurisdiction of its stakeholders including investors, creditors, employees, managers, and regulators. Good corporate governance seeks to create an institutional framework that encourages all participants to contribute towards better corporate performance through an alignment of their objectives.

4.2 Process of Concept Governance – The Evolution

At their earliest development, the business and management of corporate entities were governed in accordance only with the basic principles of agency and trust, which included the requirement for utmost good faith, transparency and accountability. However, with the growth in size of corporate entities, increasing complexities of business environment and the absence of a formal regulatory framework, basic agency and trust principles were found to be inadequate to fully safeguard and promote the interests of stakeholders. These early experiences led to the introduction of special laws to regulate registration of companies and the requirement for such companies to conform to prescribed laws, rules and practices in the conduct of their business and management. Also introduced at this time was the concept of limited liability the ultimate instrument of shareholder protection which effectively limited maximum liability of the shareholder but did nothing to safeguard and promote the investment which the shareholder had already made[17].

Entities were governed in accordance only with the basic principles of agency and trust, which included the requirement for utmost good faith, transparency and accountability. However, with the growth in size of corporate entities, increasing complexities of business environment and the absence of a formal regulatory framework, basic agency

[17] UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad (retrieved from SECP's website Oct 2006).

and trust principles were found to be inadequate to fully safeguard and promote the interests of stakeholders. These early experiences led to the introduction of special laws to regulate registration of companies and the requirement for such companies to conform to prescribed laws, rules and practices in the conduct of their business and management. Also introduced at this time was the concept of limited liability the ultimate instrument of shareholder protection which effectively limited maximum liability of the shareholder but did nothing to safeguard and promote the investment which the shareholder had already made.

Through this evolutionary process has emerged a complex system of laws, rules, and practices dealing with every aspect of corporate governance. The process of evolution continues.

4.3 Some Examples of Corporate Governance Issues

Some examples of corporate governance issues arising are the circumstances surrounding the collapse of the South Sea Company (frequently referred to as the "South Sea Bubble") in England in 1720. More recent examples are the Taj Company Scandal in Pakistan and the Enron Scandal in the United States. Many other Pakistani and international examples exist.

4.4 Definitions of Corporate Governance

4.4.1 Cadbury Report's Definition (A World Bank Report)

As has been aptly described by Sir Adrian Cadbury in the preface to the World Bank publication 'Corporate Governance: A Framework for Implementation' (September 1999):

> "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the

> stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society[18]."

4.4.2 Hampel Report's Definition on Corporate Governance

This above stated definition of corporate governance has been endorsed in various other discourses on the subject, including the 1998 final report of the Committee on Corporate Governance (the Hampel Report) by Sir Ronald Hampel.

4.4.3 Corporate Governance's Definition (OECD)

The Organization for Economic Cooperation and Development provides another perspective in its Principles of Corporate Governance by addressing five areas: (i) the rights and responsibilities of shareholders; (ii) the role of the stakeholders; (iii) the equitable treatment of shareholders; (iv) disclosure and transparency; and (v) the duties and responsibilities of the Board. It defines corporate governance as:

> "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the Board, managers, shareholders and other stakeholders, and spells out the rules and procedure for making decisions on corporate affairs. By doing this, it also provides the structures through which the company objectives are set, and the means of attaining those objectives and monitoring performance[19]."

4.4.4 Kenneth Scott's (Stanford Law School) Definition[20]

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[18] Securities and Exchange Commission of Pakistan (2002). *Code of Corporate Governance 2002*. Islamabad.(retrieved from SECP's website Oct 2006)

[19] OECD (Organization for Economic Cooperation and Development) (1999). OECD Principles of Corporate Governance. Issued by Ad hoc Task Force on Corporate Governance, Organization for Economic Cooperation and Development. http://www.oecd.org (Retrieved in October 2006).

[20] Securities and Exchange Commission of Pakistan (2002). *Code of Corporate Governance 2002*. Islamabad.(retrieved from SECP's website Oct 2006)

"In its most comprehensive sense, "corporate governance" includes every force that bears on the decision-making of the firm. That would encompass not only the control rights of stockholders, but also the contractual covenants and insolvency powers of debt holders, the commitments entered into with employees and customers and suppliers, the regulations issued by governmental agencies, and the statutes enacted by parliamentary bodies. In addition, the firm's decisions are powerfully affected by competitive conditions in the various markets in which it operates. One could go still further, to bring in the social and cultural norms of the society. All are relevant, but the analysis would become so diffuse that it risks becoming unhelpful as well as unbounded."

4.5 Origin of the term "Corporate Governance"

The term "corporate governance" came into popular use in the 1980's to broadly describe the general principles by which the business and management of companies were directed and controlled. Although its use is now common, and the objectives to be achieved thereby generally understood, there is no

The term "corporate governance" came into popular use in the 1980's to broadly describe the general principles by which the business and management of companies were directed and controlled. Although its use is now common, and the objectives to be achieved thereby generally understood, there is no universally accepted definition of "corporate governance". Although the utility of definitions is invariably exaggerated, definitions do have the advantage of providing a general framework for discussion and debate. For this purpose, and in view of the comparative infancy of the subject in Pakistan, a limited discussion of the definition of corporate governance is provided below.

Taken together, all definitions of corporate governance lead to the basic idea, which refers to the system by which companies are directed and controlled, focusing on the responsibilities of directors and managers for setting strategic aims, establishing financial and other policies and overseeing their implementation, and accounting to shareholders for the performance and activities of the company with the objective of enhancing its business performance and conformance with the laws, rules and practices of corporate governance[21].

Corporate governance is also the mechanism by which the agency problems of corporation stakeholders, including the shareholders, creditors, management, employees, consumers and the public at large are framed and sought to be resolved.

4.6 Need for Corporate Governance

Corporate governance is one of the key elements in improving economic efficiency and growth. It serves as a deterrent to mismanagement and infuses discipline in the decision making process of boards of directors. Good corporate governance encourages companies and those who own and manage them to achieve their corporate aims through a more efficient use of resources. It is empirically tested that the extent to which a company is perceived to operate within the principles of good corporate governance largely affects its ability to attract investment. With the globalization of markets, international capital flows have become extremely valuable source of finance. The companies are now able to access financing from a much larger pool of investors. It is, therefore, essential for companies to observe good corporate governance standards and be seen as such in order to competitively operate in the global capital market and to attract long-term “patient” foreign capital. The inflow of foreign capital often brings useful transfer of technology and know-how to companies, a feature that is of critical importance to developing countries in their economic progress. Even if the companies were to rely on domestic sources of finance, adherence to good corporate governance practices would help to improve the confidence of local investors, both individual and institutional. By attracting diversified domestic investors, good corporate governance is likely to reduce the cost of capital, encourage more stable sources of financing and facilitate the broadening and deepening of local capital markets.

In all, good governance is vital for the development of a healthy and competitive corporate sector. A strong corporate sector boosts “sustained” and “shared” economic growth, i.e. growth that can withstand economic shocks and benefit all. Countries can, therefore, benefit immensely from corporate governance framework as a tool to redress factors leading to sagging economic activity.

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[21] Ibid

It is critical to consider the effect of economic growth on human welfare. A sluggish economic activity results in a multitude of social problems, including poverty and unequal distribution of resources, lack of health and education facilities, unemployment and, more recently, 'brain drain' from such economies. As is obvious, these issues surface more frequently and are more disruptive in under-developed and developing economies.

The potential benefits of economic growth for human well-being are apparent from a comparison of living conditions in developing and developed countries. Bangladesh, India and Pakistan, which have real per capita GDP between USD 1,500-2,000, are among the world's lowest income nations. Nearly half of the population in these countries lives below the poverty line. In contrast, Denmark, Sweden, and the United States have real per capita GDP in the range of USD 18,000-25,000 and are three of the world's highest income nations. It is obvious that people, in general, enjoy better quality of life in the latter group of countries[22].

The evidence from China, Singapore and Brazil suggests that long-term economic growth is a significant factor in poverty alleviation. A recent study of the World Bank shows that as the economy grows, per capita income rises such that the income of the poor increases in almost the same proportion as the income of affluent does. Several development practitioners, who maintain that economic growth does not necessarily trickle down to poor and that economies need strong redistribution mechanisms to achieve poverty alleviation, challenge this view. In case of an economic downturn, it has been observed that the poor are affected more severely than the well to do. This phenomenon was clearly evident during the Asian Financial Crisis of 1997-98 when poverty rose steeply in all the countries faced with the Crisis[23].

A prime determinant of the relationship between long-term economic growth and poverty reduction is a well functioning financial sector. A strong financial sector:

- mobilizes savings from a pool of individual investors;

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[22] Cheema, Ali. (2003)
[23] Ibid

- allocates resources to technically viable and productive projects, thereby reducing the risk of individual investors; and
- Generates liquidity for both short and long-term financing needs of borrowers and reduces their transaction cost.

A strong governance structure of the financial system is of extreme importance as an efficient financial system contributes to economic progress. The economy attains optimal levels of savings and investment and capital moves towards the projects with highest expected risk-adjusted rates of return. Further, the availability of financial services to the poor enables them to channel their little savings to revenue earning projects. This means growth in the resources of all, including the poor. As the several micro-finance institutions have extended the access of the poor to financial services, it has become possible to achieve an equitable distribution of resources through the mechanism of financial system. It is expected that poverty alleviation and equitable distribution of wealth can be achieved in developing countries by encouraging long-term economic growth through a well-planned and well-implemented approach to corporate governance.

4.7 Benefits of Corporate Governance

Good and proper corporate governance is considered imperative for the establishment of a Competitive market. There is empirical evidence to suggest that countries that have implemented good corporate governance measures have generally experienced robust growth of corporate sectors and higher ability to Good and proper corporate governance is considered imperative for the establishment of a Competitive market. There is empirical evidence to suggest that countries that have implemented good corporate governance measures have generally experienced robust growth of corporate sectors and higher ability to attract capital than those which have not. The International Chamber of Commerce in its guide to corporate governance states:

> "[s]ound corporate governance practices have become critical to worldwide efforts to stablise and strengthen good capital markets and protect investors. They help companies to improve their performance and attract investment. Corporate governance enables corporations to realize their corporate objectives, protect shareholders rights, meet

> requirements and to demonstrate to the wider public how they are conducting their business … [r]esearch shows that investors from all over the world indicate that they will pay large premiums for companies with effective corporate governance[24].

One such study conducted by The McKinsey Quarterly found that institutional investors in emerging market companies would be willing to pay as much as 30 percent more for shares in companies with good governance. Furthermore, it showed that companies with better corporate governance had higher per book ratios, demonstrating that investors do indeed reward good governance. As the importance of corporate governance has been recognized by the financial sector most recently, corporate governance practices are also being looked at by rating agencies, and they have an impact on the cost of capital[25].

Radical changes have taken place in world economies over the past two decades. This change has also affected Asia. The most palpable developments can be observed in capital markets, which today demand companies that offer more transparency, stricter auditing, and more rights for minority shareholders, all of which are aspects of better corporate governance.

[24] Securities and Exchange Commission of Pakistan (2002*). Code of Corporate Governance 2002*. Islamabad.(retrieved from SECP's website Oct 2006)
[25] Ibid

5. Corporate Governance in Pakistan

5.1 Pakistani Corporate Entity

The evolution of the Pakistani corporate entities has, historically, closely followed the path taken by English corporate entities. The English Companies Act, 1844 provided the initial impetus to the development of corporations in undivided India. In 1855, the Joint Stock Companies Act was enacted in undivided India, which, for the first time, provided for registration of companies. This was followed by the Indian Companies Act, 1882 and later by the Indian Companies Consolidation Act, 1913. Upon independence, Pakistan inherited the Indian Companies Consolidation Act, 1913. In 1949, this Act was amended in certain respects, including its name, whereafter it was referred to as the Companies Act, 1913. Until 1984, when the Companies Ordinance, 1984 (the Companies Ordinance) was promulgated, following lengthy debate, Pakistani companies were established and governed in accordance with the provisions of the Companies Act, 1913[26].

Even today, under the Companies Ordinance, many provisions remain unaltered from those contained in the Companies Act, 1913 and its precursors. As a result, development of corporate law in Pakistan continues to be influenced by English company law. This has been made possible because of one of the rules of statutory interpretations, according to which if statutory provisions are consolidated or are similar or identical to previous provisions it is legitimate to refer to case law interpreting such provisions. This rule has been recognized by Pakistani courts[27].

Notwithstanding the long experience of corporations borrowed from English law and as developed in undivided India, the circumstances that have influenced and contributed to the evolution of the Pakistani corporation and corporate culture have been fundamentally different from those prevailing at any time in England or in undivided India and for that matter most other developing and developed countries. The period immediately following independence of Pakistan had thrown up quite unique challenges and opportunities for the manner in which corporations and corporate

[26] UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad
[27] Ibid

culture was to develop in Pakistan. The family company became and remains central to that development. In addition, the oldest stock exchange in Pakistan was incorporated in 1949 - two years after independence. Stock exchanges in Lahore and Islamabad have developed even later.

5.2 Corporate Governance Efforts in Pakistan

The SECP, since it took over the responsibilities and powers of the erstwhile Corporate Law Authority in 1999, has been acutely alive to the changes taking place in the international business environment, which directly: and indirectly impact local businesses. As part of its multi-dimensional strategy to enable Pakistan's corporate sector meet the challenges raised by the changing global business scenario and to build capacity, the SECP has focused, in part, on encouraging businesses to adopt good corporate governance practices. This is expected to provide transparency and accountability in the corporate sector and to safeguard the interests of stakeholders, including protection of minority shareholders' rights and strict audit compliance[28].

5.3 Need for Corporate Governance in Pakistan

The popularity and development of corporate governance frameworks in both the developed and developing worlds is primarily a response and an institutional means to meet the increasing demand of investment capital. It is also the realization and acknowledgement that weak corporate governance systems ultimately hinder investment and economic development. In a McKinsey survey issued in June 2000, investors from all over the world indicated that they would pay large premiums for companies with effective corporate governance. A number of surveys of investors in Europe and the US support the same findings and show that investors eventually reduce their investments in a company that practices poor governance[29].

Corporate governance serves two indispensable purposes. It enhances the performance of corporations by establishing and maintaining a corporate culture that motivates directors, managers and entrepreneurs to maximize the company's operational efficiency thereby ensuring returns on investment and long term productivity growth.

[28] Cheema, A (2003)
[29] Rais, Rasul Bakhsh and Asif Saeed (2005)

Moreover, it ensures the conformance of corporations to laws, rules and practices, which provide mechanisms to monitor directors' and managers' behavior through corporate accountability that in turn safeguards the investor interest. It is fundamental that managers exercise their discretion with due diligence and in the best interest of the company and the shareholders. This can be better achieved through independent monitoring of management, transparency as to corporate performance, ownership and control, and participation in certain fundamental decisions by shareholders.

Dramatic changes have occurred in the capital markets throughout the past decade. There has been a move away from traditional forms of financing and a collapse of many of the barriers to globalization. Companies all over the world are now competing against each other for new capital. Added to this is the changing role of institutional investors. In many countries corporate ownership is becoming increasingly concentrated in institutions, which are able to exercise greater influence as the predominant source of future capital. Corporate governance has become the means by which companies seek to improve competitiveness and access to capital and borrowing in a local and global market[30].

Effective corporate governance allows for the mobilization of capital annexed with the promotion of efficient use of resources both within the company and the larger economy. It assists in attracting lower cost investment capital by improving domestic as well as international investor confidence that the capital will be invested in the most efficient manner for the production of goods and services most in demand and with the highest rate of return. Good corporate governance ensures the accountability of the management and the Board in use of such capital. The Board of directors will also ensure legal compliance and their decisions will not be based on political or public relations considerations. It is understood that efficient corporate governance will make it difficult for corrupt practices to develop and take root, though it may not eradicate them immediately. In addition, it will also assist companies in responding to changes in the business environment, crisis and the inevitable periods of decline.

The need for good corporate governance in Pakistan was unmistakable. Over the last many years, the economy has been largely volatile and marred with low investor

[30] Rais, Rasul Bakhsh and Asif Saeed (2005)

confidence, tough global competition and lack of foreign investment. Among others, one of the major causes has been the lack of transparency and accountability in the corporate sector. The companies are largely closely held and managed in ways contrary to the interests of shareholders. Minority shareholders are exploited, adequate disclosures are missing and corporate information is not accessible to all.

5.4 SECP-UNDP Project on CG[31]

In order to encourage compliance with good corporate governance practices, the SEC launched a Project on Corporate Governance with the financial and technical assistance from the United Nations Development Program (UNDP) in 2002. In this respect, a Memorandum of Understanding between the Economic Affairs Division of the Government of Pakistan, the UNDP and the SEC was signed in August 2002. The objectives of this one-year Project was to develop and implement a sound corporate governance framework in Pakistan, enhance the capacity of the SEC and promote good corporate governance practices in public and private sector companies[32].

The Project was able to accomplish major goals. From the establishment of a Corporate Governance Cell within the SEC as a research and resource centre, to the organization of training workshops for directors and management of listed companies, the Project undertook focused tasks to promote the standards of corporate governance in Pakistan. In order to facilitate effective implementation of the Code, Frequently Asked Questions were compiled and published. Policy-oriented research was also carried out in order to identify desired changes in the regulatory framework for the corporate sector.

The proactive role played by the SECP under this project in promoting stakeholder awareness resulted in positive feedback from the corporate sector as well as from market analysts. This was evident by the large number of companies complying with the Code of Corporate Governance; overall we can say that there have been meaningful improvements in overall transparency and disclosure in listed companies.

[31] See Annex C for a list of Major Activities of UNDP-SECP Project on Corporate Governance
[32] UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad (retrieved from SECP's website Oct 2006).

5.5 Joint Efforts of ICAP & SECP towards developing a Code of CG

In December 1998, the Institute of Chartered Accountants of Pakistan (the ICAP) took the initiative to develop a framework of good governance in Pakistan. A committee representing the SEC, ICAP, the Institute of Cost and Management Accountants of Pakistan and the stock exchanges was established. A subcommittee was formed to undertake the task of formulating recommendations for drawing up a draft code of corporate governance.

The Code was a compilation of principles of good governance and a combined code of good practices. The Code provided a framework tailored to address the complexities of the corporate sector in Pakistan and also drew together recognized best practices as embodied in various prominent international models of corporate governance.

5.6 Launch of "Code of Corporate Governance"

On March 28, 2002, after a process of consultation with stakeholders, the draft code was finalized and issued by the SECP. The SECP, in exercise of its powers under Section 34(4) of the Ordinance, issued directions to the Karachi, Lahore and Islamabad stock exchanges to insert the provisions of the Code appropriately in their respective listing regulations. Through this measure, the Code was incorporated into the respective listing regulations of the stock exchanges and is now applicable to all listed companies.

Compliance with the provisions of the Code was made mandatory except for two that are voluntary in nature. The mandatory provisions dealt with such matters as directors' qualifications and eligibility to act as such, their tenure of office, responsibilities, powers and functions, disclosure of interest, training, meetings of the Board of directors and the business to be conduct by it, the qualifications, appointment and responsibilities of Chief Financial Officer (CFO) and company secretary, the appointment and responsibilities of the Audit Committee, the appointment and responsibilities of internal and external auditors, and compliance by listed companies with the Code[33]. The two voluntary provisions pertained to the appointment of independent non-executive directors and those representing minority interests on the Board of directors and the restriction for brokers to be appointed as directors of listed companies.

[33] Securities and Exchange Commission of Pakistan (2002*). Code of Corporate Governance 2002.* Islamabad. (Retrieved from SECP's website Oct 2006)

As a result of incorporation of the provisions of the Code into the listing regulations, the mandatory provisions of the Code were made enforceable by the respective stock exchanges in Pakistan. Any company failing to comply with any provision of the listing regulations, including those pertaining to corporate governance, was to be sanctioned, suspended or de-listed. Moreover, the SEC, being the apex regulator of the corporate and securities laws, also could take cognizance of departures from the Code & initiate relevant action/penalty[34].

5.8 Compliance with Corporate Governance amongst Pakistani Companies

Since its introduction, the Code has been generally accepted by companies – both large and small. For the purpose, the SECP undertook a number of targeted measures to promote understanding of the Code and create widespread awareness of the need for good governance. Further more, in an attempt to determine the extent to which the practices laid down in the Code are being pursued by the corporate sector; the SECP also undertook an ***impact assessment study***[35] to gauge the level of compliance with this Code of Corporate Governance[36].

The impact assessment study concluded that the introduction of the Code significantly raised transparency and accountability in the affairs of listed companies, their reporting as well as proceedings of directors[37]. There was a marked realization of role and responsibilities by all concerned, including directors, key management and auditors. However, the degree of implementation of the Code varied from business to business; the type of business and ownership pattern plays a vital role in the implementation process and the extent of its effectiveness. The study has made certain observations about implementation of the Code of Corporate Governance by family owned businesses, which will be discussed in detail in next chapter.

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[34] Securities and Exchange Commission of Pakistan (2002*). Code of Corporate Governance 2002.* Islamabad. (Retrieved from SECP's website Oct 2006)
[35] The sample questionnaire of this impact assessment study is attached as Annex D
[36] See Annex E for SECP Survey Results of Pakistani Companies for Impact of Code of Corporate Governance
[37] Ibid

5.9 Corporate Governance in Pakistan: Future Outlook

As of today, The SECP is continuing in its struggle for developing Corporate Governance framework by identifying impediments to effective implementation of the Code and addressing institutional constraints. For its success, it is imperative that the Code be followed not only in letter but in spirit as well. It is well accepted fact that good corporate governance is one of the key elements in improving economic efficiency and growth. It serves as a deterrent to mismanagement and infuses discipline in the decision making process of boards of directors.

Good corporate governance coupled with stable macroeconomic outlook will definitely encourage Pakistani companies and those who own and manage them to achieve their corporate aims through a more efficient use of resources. As it has been empirically proven that countries with good corporate governance environment attract high volumes of investments easily and quickly, so development and further strengthening of corporate governance framework in Pakistan is also necessary from the point of view of attracting foreign investors.

6. Corporate Governance in Pakistan: Observations

6.1 Origin of Corporate Governance in Pakistan:

The corporate sector regulation in any country is done solely for the purpose of healthy growth of the corporate enterprises, protection of investors and creditors, promotion of investment and development of economy and matters arising out of or connected therewith. In the last six decades Pakistani corporate sector, has considerably evolved and expanded, thereby presenting a renewed need for an effective corporate governance framework.

Corporate entities in Pakistan are primarily regulated by the SEC under the Companies Ordinance, the Securities and Exchange Ordinance, 1969, the Securities and Exchange Commission of Pakistan Act, 1997, and the various rules and regulations made there under. In addition, special companies may also be regulated under special laws and by other regulators, in addition to the SEC. In this way, listed companies are also regulated by the stock exchange at which they are listed; banking companies are also regulated by the State Bank of Pakistan; companies engaged in the generation, transmission or distribution of electric power are also regulated by the National Electric Power Regulatory Authority; companies engaged in providing telecommunication services are also regulated by the Pakistan Telecommunication Authority; and oil and gas companies are also regulated by the Oil and Gas Regulatory Authority[38].

6.2 Corporate Governance: Trends in Pakistan

The SECP, since it took over the responsibilities and powers of the erstwhile Corporate Law Authority in 1999, has been acutely alive to the changes taking place in the international business environment, which directly: and indirectly impact local businesses. As part of its multi-dimensional strategy to enable Pakistan's corporate sector meet the challenges raised by the changing global business scenario and to build capacity, the SEC has focused, in part, on encouraging businesses to adopt good corporate governance practices. This has provided much needed transparency and accountability in the corporate sector and safeguarded the interests of stakeholders, including protection of minority shareholders' rights and strict audit compliance.

[38] Rais, Rasul Bakhsh and Asif Saeed (2005)

The Code of Corporate Governance was the first step in the systematic implementation of principles of good corporate governance in Pakistan. Further measures are required, and are being contemplated by the SEC, to refine and consolidate the principles and to educate stakeholders of the advantages of strict compliance. Ultimately, a change in the way in which directors, managers, auditors, shareholders, and other stakeholders in Pakistan perceive corporate entities and their respective roles in their conduct and control will necessitate a change of corporate culture, which must not only be incremental but necessarily relevant.

6.3 Corporate Governance Reforms: Pace of Progress

Corporate Governance (CG) reform across the globe has assumed greater importance in the last couple of years. This global reform effort and policy makers' interest in corporate governance has accelerated in the wake of East Asian crisis followed by a spate of corporate disclosure failures in leading US corporations like Enron. Governments, stock exchanges and business associations across the globe are all involved in framing new CG guidelines. Such reforms are of high importance to a developing country like Pakistan, which is making concerted efforts to attract Foreign Direct Investment (FDI) and mobilize higher savings through capital markets.

Corporate Governance, in the words of Bob Garret- a visiting professor in Corporate Governance in Imperial College London and author of *Thin on Top-Why Corporate Governance matters*, can be defined as "the appropriate board structures, processes and values to cope with the rapidly changing demands of both shareholders and stakeholders in and around their enterprises"[39].

Corporate Governance (CG) reforms, initiated in the last few years by the Securities and Exchange Commission of Pakistan (SECP), have been always a vital component of the growth revival strategy being pursued by the government. Pakistan's economic performance during the 1990s has been quite dismal compared to its own historical economic growth record and to the economic performance of other South Asian countries, which have been pursuing similar policies of structural adjustment and economic liberalization during the 1990s. In view of growth-financing needs of the economy, a lot of emphasis had been placed on the reform of capital markets in order to

[39] Chaudary, Faiza A., Goergen, Marc and Shoeb I. Syed (2006)

increase the depth and efficiency of capital markets by mobilizing domestic savings and attracting foreign direct investment. One of the most important features of the growth revival strategy was the introduction of Code of Corporate Governance 2002, aimed at improvement in existing corporate governance practices and system. The rationale behind all these reform measures has always been to introduce a corporate governance system that has the ability to efficiently raise external capital, increase corporate competitiveness, and stimulate organizational growth. Such efforts since require stakeholders' education above all for their wholehearted participation so all such efforts they must be slow-paced and incremental in nature.

6.4 Main Problem/Gap Areas in Pakistan's Corporate Governance Framework:

Corporate Governance reforms in any country are important and essential pre-requisites for the development of capital markets as they provide necessary protection to the external investor. The Pakistani economic history analysis shows that the most important subsidy extended by the government to the private sector since the 1950s has been cheap credit. In a nutshell, cheap credit has more or less determined the nature of corporate finance in Pakistan and most of the corporations have financed growth either through debt or internal resources (profits re-invested to expand existing business). This pattern of corporate finance growth in Pakistan has reduced the corporate incentive to tap capital through equity markets and, therefore, has resulted in underdevelopment of the capital markets in Pakistan[40].

Furthermore, this approach also led to state of affairs where there was a lack of focus on corporate governance framework development & implementation. Ever since, such efforts have started with the introduction of code of corporate governance and other initiatives, certain impediments have been identified as having slowed down the pace of CG reforms.

[40] Cheema A., 2003

Below we make an effort to discuss the main problems areas identified;

6.4.1 Majority Shares Owned by the Family - a Dilemma for Corporate Governance

In the local listed companies, the dominance of the family as a controlling unit is apparent as the family unit controls half of the equity of an average listed textile company either through direct ownership or by virtue of ownership through associated companies. Apart from textiles, other sectors are also characterized by family dominance where the family directly or indirectly controls approximately one third of the equity of an average company.

A family can control shares in a target company either by owning shares or indirectly through associated companies, which are under their control. By retaining decision making control over capital that has been invested by external investors (banks and minority shareholders), the controller (a family-based owner manager in the case of Pakistani listed local companies) exercises and enjoys considerable discretion over the use and allocation of external investors capital. In developing countries this discretion is further strengthened due to weak disclosure requirements and poorly regulated auditing infrastructure[41]. This discretionary power is often exercised to obtain private benefits and engage in rent-seeking activities which can take various forms such as political lobbying investment, posh cars and offices, provision of expensive personal housing, and lavish personal accounts. External investors are concerned at such private rent seeking behaviour of the controller because they understand that excessive private benefit seeking by the controller often comes at the expense of their profits and dividends. In a developing country like Pakistan, external investors are not in a position to control or check the private benefit seeking behaviour of the family controller due to lack of control in local corporations and the complete dominance of the family members over the Board of Directors.

Such family oriented businesses/groups view corporate governance requirements as obstacles and an attempt to weaken their hold over their companies hence distrust such CG initiatives to the core and try very subtly to resist their implementation, which has led to a dangerous situation where most CG initiatives like the Code of corporate

[41] Bari, F. Cheema, A. & Osama Siddique (2003)

governance have been accepted only in form and not in substance[42]. However there is a strong need to understand the dynamics of such family/business groups and their relationship to corporate governance and economic development in Pakistan, for the success of corporate governance reforms.

6.4.2 Concentrated Control:

Concentrated control is a salient characteristic of Pakistani corporate governance and this feature has a number of consequences for the development of the corporate sector and capital markets in the country. Some of the important consequences of concentrated control for Pakistani corporate governance scenario can be summarized as under. SECP Audit Reports of different sectors (e.g. leasing and modaraba), suggest that concentrated control may lead to excessive private benefit seeking due to opaqueness in the use of public money[43].

A major problem in these closely held companies is that the majority of board members, executive or non-executive, belong to the same family. The concept of representatives of minority shareholders or the 'independent' directors is totally missing. Some of the companies may have a lone voice in the form of a representative from a financial institution (NIT, PICIC, Bank and Investment Companies etc), who may find it extremely difficult to make any positive contribution or raise voice of dissent. Similarly, the Audit committees may have been formed with members of the family as non-executive directors; CFO and Internal Auditors may have been employed, but with a very low key participation in the affairs of the company. In view of this type of corporate environment, any attempt to implement Code of Corporate Governance will prove to be an exercise in futility only.

However it is encouraging to see that some family dominated businesses have tried to create transparent corporate governance structures in order to protect the family reputation with external international investors. However, the number of such family dominated corporations is quite small. Although concentrated control often results in private benefit seeking behavior, one important point is that concentrated control also

[42] Rais, Rasul Bakhsh and Asif Saeed (2005)
[43] Cheema A., 2003

sets strong incentives for these families to maximize operating surpluses. Most of the family controlled companies' shares are illiquid and infrequently traded. This illiquidity of stock raises the cost of takeovers and saves family controllers from dilution of control. Share turnover is extremely low in most family-based listed companies, deterring external investors from investing due to high risk. Furthermore, family dominated corporations are not keen on declaring dividends and prefer to reallocate profits to obtain private benefits. According to the SECP Annual Report 2005, more than 40% of Pakistani corporations do not declare dividends, which is quite an alarming trend[44].

6.4.3 Role of Non-Executive Directors:

Another important aspect that requires to be examined is the effective role of NEDs as a means of minority shareholder representation. It has been observed that in the case of local private companies and MNCs, family and management controller command majority ownership whereas ownership of the remaining shareholders is quite diluted and attenuated. The matter of NEDs, with small shareholdings, and independent directors, with no shareholding, has received lot of attention in corporate governance literature across the globe. Most authors on this subject are of the opinion that such NEDs and independent directors do not have the right incentives to put in effective monitoring effort. As long as the issue of the NED incentives is not addressed properly one should not place high hopes on such directors, having minute or no ownership, to put in required effort on behalf of external investors. One alternative, suggested in corporate governance literature, is the induction of high profile professionals who have the incentive to perform in order to protect their reputation rather than being motivated by monetary incentives only. However, corporations need to settle the issue of remuneration of these directors to make the system more effective and efficacious[45].

It is generally felt that the issue of giving representation to NEDs is a thorny one and any attempt to enforce strict regulations with respect to this, will be met with greater

[44] Bari, F. Cheema, A. & Osama Siddique (2003)
[45] UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad (retrieved from SECP's website Oct 2006).

resistance. Therefore it is important; the composition of the Board is revised in due course of time. It is imperative to beef up, gradually, the number of non-executive independent directors, and representatives of minority share holdings on the boards, and restrict the number of directors representing families to say no more than 50%.

6.4.4 Minority Shareholders

The issue of minority shareholders rights also needs to be considered and examined in the local context of corporate ownership and control structure. External ownership in corporations is diluted as majority ownership rests with the controllers of MNCs and government corporations or with the families in most of the local private corporations[46]. Given this scenario of diluted ownership of external investors, it is worthwhile on the part of SECP to examine the possibility of making the requirements pertaining to external investor/ minority shareholder less demanding. Certain provisions appear quite stringent given the diluted and thin shareholding of external investors and minority shareholders. For example, some of the demanding provisions include requirements such as a call for an extraordinary shareholder meeting is 10% and calls for special resolution 10%[47]. The provision of the right to issue non-voting shares in the context of Pakistan's inefficient capital markets may result in making external investor protection even weaker. Another pertinent issue is that of dividends being declared by the BOD. In Pakistan's family dominated local corporations, BOD may not be the best forum for the protection of cash-flow rights of external investors and minority shareholders, so alternatives needs to be explored.

6.4.5 Difference in CG Compliance amongst MNCs & SMEs

It has been observed that MNCs are better at compliance with corporate governance as they understand the importance of the corporate governance for better company performance, risk management, higher profits, good working relations between the management and owners and above all the growth of the economy[48]. The real challenge to implementing the Code of Corporate Governance is presented by the other category of business entities, SMEs. In Pakistan, the multi-national companies, large business entities, and the financial institutions were already following a number

[46] Cheema A., 2003
[47] Rais, Rasul Bakhsh and Asif Saeed (2005)
[48] Ibid

of best corporate governance practices even before their formal introduction. In their case, such initiatives have further strengthened and streamlined these practices and the corporate sector, as a whole, has adopted uniform policies of governance. However the implementation of the corporate governance framework in substance is still missing in small and medium sized companies without any discrimination. This is mainly due to the perception amongst several small, medium and even large companies mostly in the non-financial sector (where majority shareholding is family owned) that it is detrimental to their interests to implement these rather stringent restrictions, as they feel that there is no tangible reward for them accruing from following the laid down corporate governance framework unlike MNCs and these measures come at an exorbitant cost. According to a paper presented by Mr. Mumtaz Abdullah at SAFA conference in Karachi on May 2-3 2003, these extra costs have been estimated at Rs. 3 million per annum[49].

Table 1: Extra Costs arising due to the implementation of Code of Corporate governance

	DEPARTMENT/OFFICIAL/ACTIVITY	EXTRA COST IN RS. ('000s)
1.	Internal Audit	300
2.	Accounts Department.	500
3.	Secretary's Department	100
4.	CFO	400
5.	Printing of Reports	400
6.	Printing of Extra Copies of Register of Shareholders Policies etc	100
7.	Additional Postage	300
8.	Directors T.A.	200
9.	Meeting Expenses	150
10.	Telephone and Fax	150
11	Statutory Fees	200
12.	Registrar and CDC	100
13.	Audit Fees	100
	TOTAL	3,000

Source: "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad

Such exorbitant costs remain the biggest impediment in enforcement of corporate governance practices in such companies. Also there is a need to allow a certain degree of flexibility in implementation of corporate governance framework when it comes to Small and medium sized companies.

[49] UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad (retrieved from SECP's website Oct 2006).

7. Conclusion & Recommendations:

In the last chapter, we discussed in detail the major impediments in the way of the corporate governance reforms. From this discussion, we can infer that polar patterns in terms of ownership and control of Pakistani Corporates are to some extent the biggest problem. However it is crucial for us to understand that agency problem we have in Pakistani corporations is not the main type of agency problem i.e. between the management and the shareholders as described in most of the academic literature, but between the large shareholder and the minority shareholders. This agency problem is further exacerbated by weak corporate governance mechanisms, inadequate disclosure and ineffective auditing practices prevalent here[50].

But with the recent efforts for development of corporate governance framework, we can say that that situation is fast changing. This study has reviewed some of the recent reforms of corporate governance, such as the introduction of the Corporate Governance Code (2002). On the whole, we can say that implementation of the Code has resulted in significant organizational and corporate culture improvements, as compared to the situation prevalent prior to the implementation of the Code. It may, however, be added that for well-managed companies, both local and multinational, best practices of corporate governance were already in vogue to a great extent. The situation existing in the small and closely held privately owned businesses was and still remains the biggest challenge as discussed already. The family ownership and concentrated structures have indeed created a challenging environment for reformers of company law and corporate governance. When it comes to assess conformity with corporate governance framework in place, various studies done to assess impact & compliance have shown that the compliance with the Code tends to be high in terms of the areas that have less far reaching consequences than in areas that really matter like controlling shareholders, non-executive directors' relationship between minority shareholders and the managements[51].

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[50] Chaudary, Faiza A., Goergen, Marc and Shoeb I. Syed (2006)
[51] Cheema A., 2003

Critics have argued that the Code have been implemented in form only, while the substance is totally missing. But here all concerned should realize that the Code is presently passing through an evolutionary process. It is felt that diligent enforcement and implementation and further improvement in certain areas will allay the concerns of these companies, leading to acceptance of the Code as a norm. At the end of this thesis study, we feel that the best way to go forward from here is continuing efforts aimed at bringing in gradual change in attitudes of managements, BODs and inclusion of educated and qualifies non-executive directors, thus making BOD an agent of change for improving company compliance and adherence to Corporate Governance Framework.

Another major inference that emerged out of this thesis study is that there is no denying the fact that regulation matters for good corporate governance. In this respect, while we can say that the chief regulator, SECP has engaged in wide-scale internal institutional strengthening before it embarked upon the task of improving corporate governance framework in the country, but there is a lot that still can be done to enhance its capacity. Such an institutional strengthening exercise is vital as only internally sound regulator can better regulate the entities. In Pakistan, we have the example of State Bank of Pakistan to learn from. In the past few years, SBP has undergone a wide range of reforms and has emerged as a better and more effective regulator of the banking industry in Pakistan. As a result, the corporate governance standards in the banking sector have improved considerably and are now considered highest amongst all regional countries[52]. This achievement is a testament to the fact that to regulate better, the regulator needs to more efficient. While the initial rate of reforms & restructuring at SECP was quite fast-paced, of late this has taken a sluggish pace. It seems that since the departure of last chairman and KSE Crash incident, SECP has lost its focus and zeal on other fronts as well. This can severely hamper the further development of corporate governance framework in Pakistan and is a situation which demands immediate attention.

[52] A recent World Bank study on South Asia “Access to Finance” ranked Pakistan corporate governance standards highest among South Asia

The experience of several developed and developing countries clearly reflect that the required action at this stage in development of corporate governance framework should be the establishment of transparent and accountable systems of public policy and governance and enhanced capacity of regulators for Regulatory Impact Assessment of CG standards in the country[53]. It is the task of the men at the helm to introduce relevant changes in our regulatory structures to make them more compatible with international norms and standards. There has already been a sea change in the regulatory apparatus of the country. However we need more such positive actions in letter and spirit, to further strengthen & ensure the effectiveness of corporate governance framework in Pakistan for a long time to come.

To conclude, Pakistan has made major strides in improving the governance of its corporations in general. However, more efforts need to be made in terms of improving levels of compliance with the regulatory framework and to further strengthen the regulatory framework. Given its crucial role in promoting and sustaining economic development, both regulators and Pakistan's Corporates need to be aware of their own role of being the fore-bearers in setting high corporate governance standards.

[53] Rais, Rasul Bakhsh and Asif Saeed (2005)

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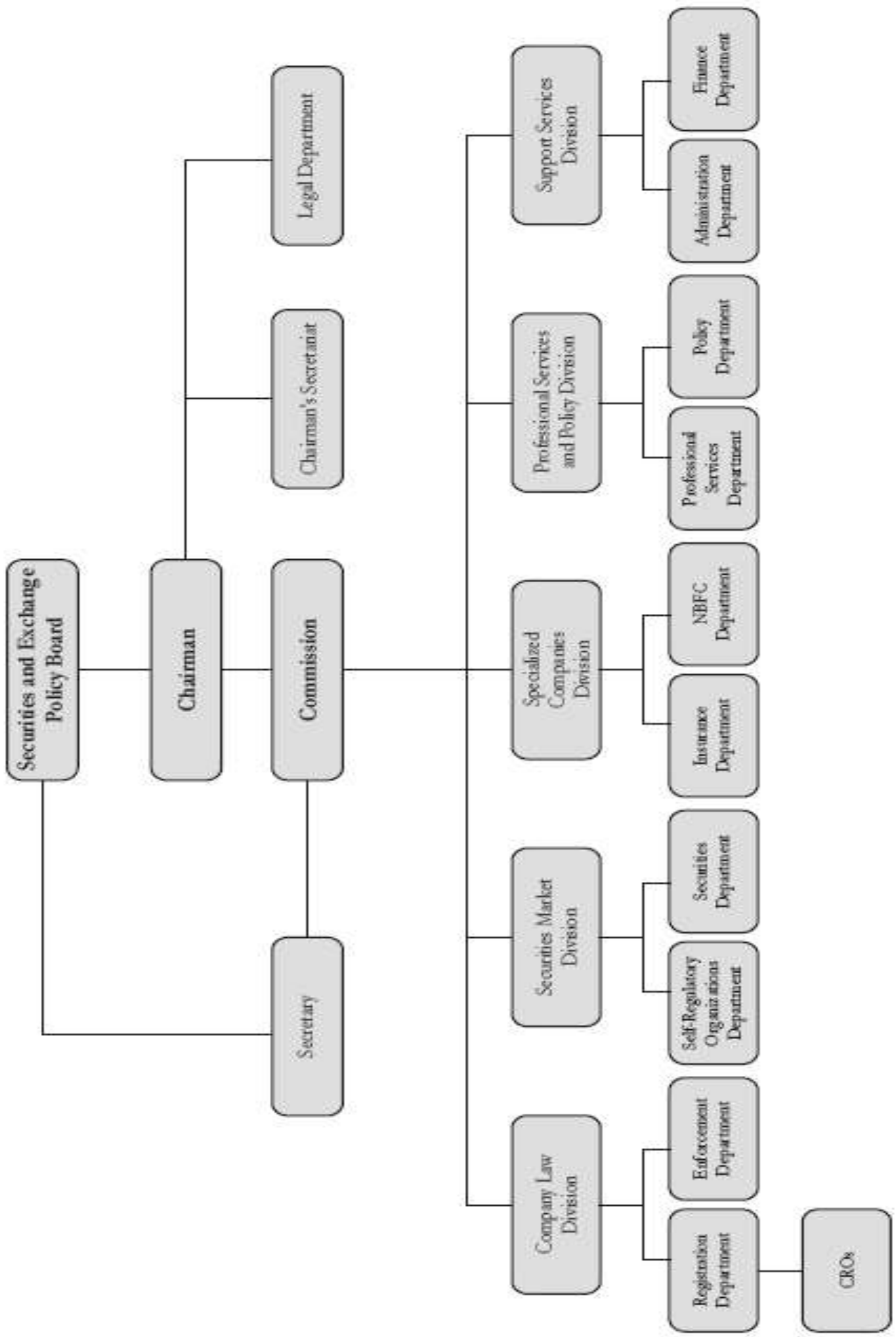
'Annex A'

Organogram of SECP



‘Annex B’

Major SECP Publications on Corporate Governance

Title of Publication	Date of Publishing
Investor Guide Volume I	August 2002
Investor Guide Volume II	August 2002
Investors' Guide to Lodging Complaints	August 2002
Code of Corporate Governance	November 2002
Frequently Asked Questions on Corporate Governance	November 2002
Brief Series on Corporate Governance	Initiated in January 2003
Manual on Corporate Governance	January 2004
Directors and Secretaries Guide	March 2004
Guide on Accounts and Accounting Reference Dates	July 2004
Single Member Companies Guide	December 2004

Note: All these publications are available at the SECP's website www.secp.gov.pk

'Annex C'

Major Activities of UNDP-SECP Project on Corporate Governance

❖ Corporate Governance Cell established at the SEC	Islamabad, Pakistan	November 2002
❖ Consultative meetings	Malaysia, Singpaore and Hong Kong	November 2002
❖ Seminar on Strengthening Corporate Governance	Lahore, Pakistan	November 2002
❖ FAQs published	Islamabad, Pakistan	November 2002
❖ Workshop on Responsibilities of Directors and Management of Listed Companies	Islamabad, Pakistan	December 2002
❖ Study on harmonizing the Code of Corporate Governance with other laws and regulations in Pakistan	Islamabad, Pakistan	January 2003
❖ Brief series issue no. 1	Islamabad, Pakistan	February 2003
❖ Workshop on Responsibilities of Directors and Management of Listed Companies	Karachi, Pakistan	March 2003
❖ Workshop on Responsibilities of Directors and Management of Listed Companies	Lahore, Pakistan	March 2003
❖ Fifth Asian Roundtable on Corporate Governance	Kuala Lumpur, Malaysia	March 2003
❖ First issue of e -newsletter completed	Islamabad, Pakistan	March 2003
❖ Brief series issue no. 2	Islamabad, Pakistan	March 2003
❖ Electronic resource centre initiated	Islamabad, Pakistan	April 2003
❖ Brief series issue no. 3	Islamabad, Pakistan	April 2003
❖ Consultative meetings	London, U.K.	May 2003
❖ Fourth International Conference on Corporate Governance	London, U.K.	May 2003
❖ Feasibility study for Institute of Corporate Governance started	Islamabad, Pakistan	May 2003
❖ Research on institutional shareholders and the promotion of corporate governance in Pakistan	Islamabad, Pakistan	May 2003
❖ Workshop on Significant Issues in Corporate Governance	Islamabad, Pakistan	June 2003

'Annex C'

❖ Seminar on Corporate Social Responsibility	Islamabad, Pakistan	June 2003
❖ Study on evaluation of the state of corporate governance in Pakistan	Islamabad, Pakistan	June 2003
❖ Brief series issue no. 4	Islamabad, Pakistan	June 2003
❖ SAFA Conference on The Accounting Profession: Way Forward	Karachi, Pakistan	June 2003
❖ Insurance Guide published	Islamabad, Pakistan	June 2003
❖ Workshop on International Accounting Standards and SAFA Regional Seminar on Harmonization of Accounting Standards in the SAFA Region	Colombo, Sri Lanka	July 2003
❖ Study tour	Kuala Lumpur, Malaysia	July 2003
❖ Second issue of e-newsletter completed	Islamabad, Pakistan	July 2003
❖ Second Humboldt Forum on Corporate Governance	Berlin, Germany	July 2003

'Annex D'

SAMPLE QUESTIONNAIRE

Note: This questionnaire is an excerpt from UNDP (United National Development Program) (2003), "Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad (retrieved from SECP's website Oct 2006).

COMPANY INFORMATION

Name of the Organization:

Contact Person's Name and Telephone Number:

Date of completing the questionnaire:

QUESTIONNAIRE ON

EVALUATION OF IMPLEMENTATION OF CODE OF CORPORATE GOVERNANCE

RESPONSE

BOARD OF DIRECTORS' APPOINTMENT:

1. How many Directors are presently serving on your board?

Of whom: Executive

Non-Executive/Independent

Representing: Financial Institution/Bank/Modaraba

Minority Shareholders

Others

YES NO

2. Did anyone among minority shareholders contest election for a Director's slot on the board of your organization?

3. Has the Chairman of Board of Directors (BOD) been elected from?

Executive Directors

Non-Executive Directors

	YES	NO
4. Is the same individual holding the posts of Chairman and Chief Executive in your organization?		
5. Are the functions of Chairman/CEO clearly defined by the Board of Directors (BOD)?		
6. Is any of your Directors serving more than ten BODs of listed Companies?		
7. Have you ensured that your Directors meet requirement of qualification as per clause (iv) & (v) of the Code of Corporate Governance (CCG)?		
8. Have you arranged 'Orientation Courses' for your Directors in order to acquaint them with their responsibilities as per requirement under the Code of Corporate Governance (CCG) & the Company Ordinance 1984?		

DUTIES AND RESPONSIBILITIES:

	YES	NO
9. Has a statement of Ethics and Business Practices been issued by the BOD & has it been signed by all the Directors & employees?		
10. Has the BOD adopted a vision/mission statement?		
11. Has the BOD formulated Corporate Strategy & announced significant policies? (Please see viii (b) of the CCG)		
12. Is a complete record of particulars of significant policies being maintained?		
13. Are all significant matters brought to the attention of the board e.g. investments, divestments, writing off bad debts, inventories etc?		
14. Has the BOD ensured implementation of an effective system of Internal Control?		
15. Are the terms of appointment & remuneration package of the CEO & the Executive-Directors approved by the BOD?		

YES NO

16. In the case of Modaraba or a Non-Banking Financial Institution, is an 'Investment Policy' clearly defined & reported in the Annual Report- as per clause viii(f) of CCG ? If not applicable just write N/A

MEETINGS OF THE BOARD:

17. How many meetings of the BOD have taken place over the last 12 months?

18. Does the management ensure that the notice is sent seven days prior to the meeting (except in case of emergency)?

19. Are the minutes of the meeting properly recorded in the minutes book & subsequently circulated to the Directors within 30 days of the meeting for their comments?

20. Have any notes of dissention by the Directors been recorded in the minutes over the last 12 months?

21. Has any Director filed any objection with the SECP, in case a note of dissention has not been recorded in minute book?

22. Are all significant issues placed at Board meeting for their consideration, as per terms of clause (viii) of CCG?

APPOINTMENT OF CHIEF FINANCIAL OFFICER (CFO) & COMPANY SECRETARY (CS) and THE HEAD OF INTERNAL AUDIT (HIA):

23. Has the appointment of the following been approved by the Board on the recommendation of CEO?

CFO
CS
HIA

24. Has any one of the following been removed, with the approval of the Board, over the last 12 months?

CFO
CS
HIA

25. Which of the following qualifications does the CFO of your organization hold?

Member of a recognized body of professional accountants
Graduate from a recognized university and 5 years of experience
None of the above

26. Which of the following qualifications does the CS of your organization hold?

Member of body of professional accountants/corporate secretaries
Lawyer or a recognized university graduate with 5 years experience
None of the above

	YES	NO
27. Do CFO & CS attend all the meetings of the Board?		

CORPORATE & FINANCIAL REPORTING FRAMEWORK:

28. Does the Directors' report contain all the statements as required under Sec 236 of Company's Ordinance1984 & as per guidelines under clause (xiv) of Code of Corporate Governance?

29. Are quarterly unaudited financial statements circulated to the shareholders after approval by the BOD within 30 days?

30. Are half yearly accounts subjected to a limited scope review before approval by the BOD and circulated to the Shareholders?

31. Are annual accounts circulated not later than four months from the closing of the financial year?

YES NO

32. Does your company circulate the required information to the Stock Exchange immediately after approval of the Accounts by the BOD?

33. Are all your statement of Accounts signed by the CEO & CFO, after approval & authorization by the BOD before circulation to the Shareholders?

34. Regarding 'Disclosure of interest by a Director Holding Company Shares', are the requirement of clause (xxvi) of CCG being met by the Company?

35. Do your external Auditors or any partner of the firm or his/her spouse or minor children hold any position in the shares of your company?

36. If the external Auditors held any shares in your Company before their appointment, have those shares been divested?

(N/A if not applicable)

37. If any share capital has been issued over the last 12 months, how much of it was offered to the general public?

AUDIT COMMITTEE:

38. Has an Audit Committee been established in your Company, if so when? (Please state month/year)

39. How many Directors are members of the Audit Committee?

Executive
Non-Executive

40. Is the Chairman of the Committee an

Executive Director
Non-Executive Director

41. Who acts as the secretary of the Committee?

Internal Auditor

CS
Other

42. How many meetings of the Audit Committee took place during the last twelve months?

YES	NO

43. Did CEO & CFO also attend the Committee meetings?

During the last 12 months:

44. Did the Committee meet the External Auditors without CFO and the Head Of Internal Audit?

45. Did the Committee meet the HIA and other members of the Internal Audit function without CFO and theexternal Auditors?

46. In addition to review of financial statements, how many Internal Audit Reports were presented to the Audit Committee by the Head of Internal Audit?

INTERNAL AUDIT FUNCTION:

47. If there is an in-house Audit Department, how many members does it have?

48. Who does the Head of Internal (HIA) Audit report to?

CEO
CFO

49. Is the Internal Audit function outsourced fully/partly?

50. In case the function is outsourced, who is the person responsible for liaison in the Company?

HIA
CFO
CS

51. Does the HIA have direct access to the Chairman Audit Committee?

52. Are Internal Audit Reports provided to the External Auditors?

	YES	NO
53. Over the last 12 months, have the Auditors, reported any significant matters to the Audit Committee?		

EXTERNAL AUDITORS:

54. Have your External Auditors been appointed as per guidelines contained in clause (xxxvii-xxxix) of CCG?		
55. Have you appointed separate Management Consultants to advise on matters other than audit?		
56. After the last annual audit, was a Management letter provided to the BOD within 30 days from the date of the Audit Report?		
57. Was the Management letter discussed at the Audit Committee/BOD and response was sent to the Auditors?		
58. Did a partner representing the External Auditors attend the last Annual General Meeting, when the Accounts were discussed?		

COMPLIANCE WITH THE CCG:

59. Has your company published and circulated a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance?		
60. Has your company ensured that the statement of compliance with the best practices of corporate governance is reviewed and certified by statutory auditors, where such compliance can be objectively verified, before publication by listed companies?		

SUGGESTIONS AND PROBLEMS REGARDING CODE OF CORPORRATE GOVERNANCE

61. Has the implementation of the Code of Corporate Governance contributed to any improvement in operational and organizational efficiency? Please Comment.

62. Are you facing any problems in implementing the requirements of the Code of Corporate Governance (CCG)? Do you have any proposals to overcome these impediments to make CCG more effective?

63. Any other comments that you might have about the code or state of corporate governance in the organization.

‘Annex E’

IMPACT OF CODE OF CORPORATE GOVERNANCE
SURVEY RESULTS OF PAKISTANI COMPANIES

Note: This questionnaire is an excerpt from UNDP (United National Development Program) (2003), “Impact Assessment of the Corporate Governance Code 2002, United Nations Development Program, Islamabad (retrieved from SECP’s website Oct 2006).

4. SURVEY METHODOLOGY AND FINDINGS

4.1 Methodology

A survey was conducted to assess the implementation of the Code of Corporate Governance, highlight the progress made in terms of organizations' operational efficiencies and to identify problems being faced by different corporations in implementing the Code. The survey consisted of

- A Questionnaire mailed or emailed to 95 listed companies
- Telephone interviews and conversations with various CEOs and CFOs of different corporations
- Personal visits of different companies
- Meetings with directors of Karachi Stock Exchange and exchange of opinion with the Presidents of Lahore Stock Exchange and Islamabad Stock Exchange personally or through email
- Detailed meetings with head of audit firms who have played an important role in the initial formulation of the Code of Corporate Governance by ICAP

A questionnaire was designed to assess the extent and effect of implementation of the Code of Corporate Governance on listed companies. Three documents, namely the Code of Corporate Governance 2002, the Listing Regulations of the Karachi Stock Exchange, and the Companies Ordinance 1984 were consulted in formulating questions in the questionnaire. The questionnaire consisted of 62 questions, out of which nearly 50 questions could be answered in a dichotomous (yes/no) manner. The main purpose and intent behind designing the questionnaire in such a simple way was to make it easy for the company to respond and thereby get a higher response to the questionnaire.

All issues in the Code of Corporate Governance 2002 such as minority share-holders, audit committees, composition of the board, compliance with Code provisions, financial disclosure requirements and appointment of important officials in line with the Code provisions were covered. Three descriptive questions were included, dealing with areas such as progress made in terms of operational and organizational efficiency, problems faced in implementing the Code and suggestions for improvement in the Code. A sample questionnaire has been attached in Appendix A. The complete list of 95 listed companies, to which this questionnaire was dispatched, can be found in Appendix B.

Out of 95 companies targeted, 40 companies responded to the questionnaire-amounting to nearly 42% response rate. Given the limited time frame, this response rate can be termed extremely encouraging and satisfactory. However, it needs to be mentioned that this satisfactory response was obtained after persistent follow-up efforts by both consultants. The response received from different companies was quite diversified in terms of sectoral representation and the responding companies belonged to all three categories of market capitalization such as large cap, small cap and medium cap. These companies belonged to different ownership structure categories such as multinationals, government owned corporations, private companies and family owned entities. The complete list of the 40 companies who responded to the questionnaire is shown in Table 4.1.

Table 4.1: List of Companies who Responded to the Questionnaire

	Sector	Company	Market Capitalization (Rs. in million) as on 12 June, 2003
1.	Auto	Atlas Honda	1,492
2.	Banks	Asset Investment Bank	33
3.	Banks	Askari Commercial Bank	3,225
4.	Banks	Arif Habib	1,800
5.	Banks	PICIC	2,616
6.	Cement	Pioneer Cement	573
7.	Cement	Fauji Cement	2,021
8.	Coating	Berger Paints	125
9.	Dairy and Beverages	Nestle Milk Pak	10,051
10.	Electrical Goods	Pakistan Cables	206
11.	Energy	Hub Power Company	41,253
12.	Engineering	KSB Pumps	210
13.	Engineering	Crescent Steel	1,195
14.	Fertilizers	Engro Chemicals	12,908
15	Fertilizers	Fauji Fertilizers	22,469
16.	Food	Lever Brothers	17,548
17.	Food	National Foods	247
18.	Insurance	International General Insurance	2,242
19.	Gas	Mari Gas Company	1,719
20.	Insurance	Century Insurance	425
21.	Leasing	Dawood Leasing	255
22.	Leasing	Crescent Leasing	271
23.	Leasing	Orix Leasing	1,770
24.	Leasing/Modaraba	Al-Zamin Leasing Modaraba	71
25.	Miscellaneous	General Tyre and Rubber Company	2,738
26.	Modaraba	First Grindlays Modaraba	1,403
27.	Paper and Board	Security Papers	2,528
28.	Paper and Board	Packages	6,180
29.	Paper Boards	Century Paper Mills	1,822
30.	Paper Boards	Merit Packaging	137
31.	Petroleum	Pakistan Refinery Limited	3,645
32.	Petroleum	National Refinery Limited	5,998
33.	Pharmaceutical	Glaxo Smith Kline	7,221
34.	Pharmaceutical	Reckitt Benkiser	2,036
35.	Pharmaceutical	Abbot Laboratories	4,355
36.	Pharmaceutical	Wyeth Laboratories	1,493
37.	Textile	Gul Ahmed	2,089
38.	Tobacco	Pakistan Tobacco	6,707
39.	Toiletries	Gillete Pakistan	1,593
40.	Vanaspati	Punjab Ghee Mills	4

Out of these 40 companies, nearly 15 companies were selected for follow up personal visits and telephonic conversations/interviews. The main purpose of these meetings was to assess corporate practices prevalent in different companies prior to implementation and introduction of the Code. Important issues such as problems faced in implementing the code, improvements in organizations' operational efficiency and recommendations for further refining the Code were discussed in detail with the CEOs and CFOs of those companies who had chosen to respond to the questionnaire.

In addition to listed companies, discussions were also held with directors of Karachi Stock Exchange. The questionnaire was also sent to the Presidents of Lahore Stock Exchange and Islamabad Stock Exchange. President of Lahore Stock Exchange sent his suggestions by responding to the last three questions of the Questionnaire.

Detailed opinion was also sought from heads of various audit firms and ICMAP/ICAP, as these institutes were instrumental in framing the Code in the first place. Mr. S. Masoud Ali Naqvi, Senior Partner of KPMG, Mr. Ebrahim Sidat, Country Managing Partner/CEO of Ford Rhodes Sidat Hyder & Company and Mr. Asad Ali Shah, Senior Partner of M.Yousuf Adil Saleem & Company were approached for their detailed suggestions regarding improvements in the existing Code. All of them contributed with extremely valuable suggestions, identifying many areas that need to be beefed up and certain provisions that had resulted in implementation problems.

Other prominent professionals who were approached for suggestions included Mr. Ahmed Patel, Chairman – Executive Board of Ford Rhodes, Mr. Sher Afghan, President of ICMAP, Mr. Aslam Dossa, Executive Director and Mr. Khaliq-ur-Rehman, Deputy Managing Partner of Anjum Asim Shahid and Mr. Sohail Hasan Senior Partner, Fergusons.

Our profound thanks are also due to Mr. Zahid Zaheer, Secretary General Overseas Investors Chamber of Commerce and Industry, Mr. Zafar Abdullah, General Manager Operations, Karachi Stock Exchange, Mr. Basheer Chaudhry CEO, Al-Zamin Leasing Company, Mr. Ahsan Saleem CEO, Mr. S. M. Ehtishamullah CFO, Crescent Steel and Allied Products Ltd. Mr. Usman Masood Khan, Executive Director, Pioneer Cement, Mr. Badruddin Fakhri CFO, Pioneer Cement, Mr. Tajammal Shah, Company Secretary Pakistan Tobacco Limited, Mr. Arshad Rahim Khan CEO/Chairman Wyeth Pakistan and Mr. Khawaja Bakhtiar Ahmed CFO, Wyeth Pakistan, who gave their valuable time to discuss the issues and provided useful and pertinent suggestions and recommendations.

Mr. Hassan Bilgrami of NIT, a mutual fund represented on more than 240 Boards, provided an in-depth analysis of prevalent corporate governance practices and suggestions for improving these practices.

4.2 Findings of the Questionnaire

The Questionnaire was designed to assess the extent and effect of implementation of the Code. In this section, findings pertaining to implementation of the Code of Corporate Governance have been reported. Prevalent and past corporate governance practices have been analyzed in the next section whereas subsequent sections discuss progress made or problems encountered after the introduction of the Code. The findings of the Questionnaire have been discussed under the following headings:

- Composition of the Board of Directors.
- Duties and Responsibilities
- Meetings of the Board
- Appointment of Officials
- Corporate and financial disclosure framework
- Audit Committee
- Internal Audit
- External Audit
- Compliance with CCG

4.2.1 Composition of the Board of Directors

On average the Board consists of 9 directors, comprising 3 Executive Directors and 6 Non-Executive Directors. The most common board composition is 7 directors, consisting of 4 Executive and 3 Non-Executive/Independent Directors. As most companies thought that the definition of Independent Directors is not clear, therefore Non-Executive and Independent Directors were clubbed together in the Questionnaire as single category. Crescent Steel pointed out that it has recently disclosed the names of two 'Independent Directors' on its Board in their Annual Report. For the purpose of this study, Non-executive and Independent directors were treated as a single category.

Detailed profiling of Non-Executive/Independent Directors revealed that on average 1 director belonged to Financial Institutions, 1 to minority shareholders and 4 belonged to categories other than financial institutions or minority shareholders.

Out of a sample of 40 companies, 15 companies (38%) had representation of minority shareholders on their board. 16 out of 40 companies (40%) stated that minority shareholders contested the election for the slot of non-executive director.

Some organizations also indicated that the elections of the Board of Directors were held before the introduction of the Code of Corporation Governance and, therefore, there were no minority shareholders in the current Board.

28 out of 40 Companies (70%) stated that the Chairman of the Board of Directors belonged to the category of Non-Executive Directors whereas remaining 12 companies (30%) had Chairman elected from Executive Directors.

Only in 12 companies (30%), the same individual held the offices of both Chairman and the Chief Executive- 28 companies had different individuals acting as Chairman and Chief Executive of their organization.

All companies who responded to the questionnaire stated that the functions of the Chief Executive and Chairman had been clearly defined by the Board and all the requirements regarding qualifications of a Director, as laid out in the Code, have been complied with.

6 companies (15%) out of 40 stated that the NIT Director serving on the board of their company was serving on the boards of more than 10 companies. The remaining 34 companies did not have any director, who was serving on more than 10 boards.

Orientation courses have been arranged for directors by 32 (80%) out of 40 companies, whereas the remaining 8 were in the process of arranging these courses.

Table 4.2: Responses Regarding Board of Directors

		AVERAGE
How many Directors are presently serving on your board?		9.1
Of whom:	Executive	2.6
	Non-Executive/Independent	6.5
Representing:	Financial Institution/Bank/Modaraba	1.6
	Minority Shareholders	1.0
	Others	4.7
Has the Chairman of Board of Directors (BOD) been elected from?		
	Executive Directors	12 (30%)
	Non-Executive Directors	28 (70%)

	YES	NO
Did anyone among minority shareholders contest election for a Director's slot on the board of your organization?	16 (40%)	24 (60%)
Is the same individual holding the posts of Chairman and Chief Executive in your organization?	12 (30%)	28 (70%)
Are the functions of Chairman/CEO clearly defined by the Board of Directors?	39 (97%)	1 (3%)
Is any of your Directors serving more than ten BODs of listed Companies	6 (15%)	34 (85%)
Have you ensured that your Directors meet requirement of qualification as per clause (iv) & (v) of the Code of Corporate Governance (CCG)?	40 (100%)	0
Have you arranged 'Orientation Courses' for your Directors in order to acquaint them with their responsibilities as per requirement under the Code of Corporate Governance (CCG) & the Company Ordinance 1984?	32 (80%)	8 (20%)

4.2.2 Duties and Responsibilities

38 companies (95%) stated that the 'Statement of Ethics and Business Practices' has been issued and signed by directors and employees. Companies, who stated that the statement has not been issued, clarified that they were in the process of issuing this statement.

All companies stated that the Board of Directors has formulated corporate strategy and announced significant policies, and ensured implementation of an effective system of Internal Control. All companies declared that a complete record of particulars of significant policies is being maintained.

Only 1 company (a family dominated enterprise) stated that all significant matters are not brought to the attention of the board. The remaining 39 companies declared that all significant matters, as laid out in the Code of Corporate Governance, are brought to the attention of the Board. Similarly one company stated that the Mission/Vision statement would be presented in the next Board meeting whereas the remaining 39 companies stated that the BOD had adopted the mission/vision statement.

Among 40 companies who responded were 3 Modaraba companies and all three stated that their company has clearly defined an "Investment Policy"

39 companies (97%) reported that the BOD has approved the appointment and remuneration package of the CEO and Executive Directors. Only one company replied in the negative as this company had its CEO and Directors nominated and their remuneration package approved by the parent company.

Table 4.3: Responses Regarding Duties and Responsibilities

	YES	NO
Has a statement of Ethics and Business Practices been issued by the BOD & has it been signed by all the Directors & employees?	38 (95%)	2 (5%)
Has the BOD adopted a vision/mission statement?	39 (97%)	1 (3%)
Has the BOD formulated Corporate Strategy & announced significant policies? (Please see viii (b) of the CCG)	40 (100%)	0
Is a complete record of particulars of significant policies being maintained?	40 (100%)	0
Are all significant matters brought to the attention of the board e.g. investments, divestments, writing off bad debts, inventories etc?	39 (97%)	1 (3%)
Has the BOD ensured implementation of an effective system of Internal Control?	40 (100%)	0

Are the terms of appointment & remuneration package of the CEO & the Executive-Directors approved by the BOD?	39 (97%)	1 (3%)
In the case of Modaraba or a Non-Banking Financial Institution, is an 'Investment Policy' clearly defined & reported in the Annual Report- as per clause viii(f) of CCG ? If not applicable just write N/A.	3 (7%)	37 (N/A) (93%)

4.2.3 Meetings of the Board

On average 5 Board meetings per company took place during the last year. The highest number of Board meetings reported was 17 and the lowest was 4. All companies responded that the management ensures that the notice is sent seven days prior to the Board meeting. Moreover, minutes are properly recorded in the minutes book and subsequently circulated to the Directors within 30 days of the meeting for their comments. Similarly all companies stated that all significant issues are placed at Board meeting for its consideration.

33 companies (83%) reported that no note of dissent has been recorded by the Directors in the minutes over the last 12 months. Only 1 company reported that a Director has filed an objection with SECP over non-recording of the note of dissent.

Table 4.4: Responses Regarding Board Meetings

	AVERAGE	
How many meetings of the BOD have taken place over the last 12 months?	5.85	
	YES	**NO**
Does the management ensure that the notice is sent seven days prior to the meeting (except in case of emergency)?	40 (100%)	0
Are the minutes of the meeting properly recorded in the minutes book & subsequently circulated to the Directors within 30 days of the meeting for their comments?	40 (100%)	0
Have any notes of dissent by the Directors been recorded in the minutes over the last 12 months?	7 (17%)	33 (83%)
Has any Director filed any objection with the SECP, in case a note of dissention has not been recorded in minute book?	1 (3%)	39 (97%)
Are all significant issues placed at Board meeting for their consideration, as per terms of clause (viii) of CCG?	40 (100%)	0

4.2.4 Appointment of Officials

33 companies (83%) responded that the Board had appointed the CFO after approval. The remaining 7 companies stated that the appointment was made before the introduction of the Code and, therefore, the requirement of Board approval would be applicable whenever the next CFO is appointed. Similarly, 88% and 85% of the companies stated that the Board has appointed the Company Secretary and Head of Internal Audit respectively after approval. Companies, who had appointed these officials before the introduction of the Code, did not get the approval from the Board, as it was not mandatory to get Board approval before the Code's introduction.

Three companies reported that the CFO of their organization has been removed during the last one year after getting approval for removal from the Board. Two different companies stated that the Head of Internal Audit and the Company Secretary of their respective organizations was removed after Board approval.

CFO of 30 companies is a member of a recognized body of professional accountants. On the other hand, 13 companies stated that their CFO was a graduate from a recognized university and had 5 years of professional experience. Some of the CFOs had dual qualifications whereas only 2 companies reported that their CFO did not have any of the aforementioned qualifications.

22 companies reported that the Company Secretary of their organization was a member of body of professional accountants/corporate secretaries. On the other hand, 20 companies reported that their Company Secretary was a Lawyer or a recognized university graduate with 5 years of professional experience.

All companies averred that the CFO and the Company Secretary attended all Board meetings.

Table 4.5: Responses Regarding Appointment of Officials

	YES	NO
Has the appointment of the following been approved by the Board on the recommendation of CEO?		
CFO	33 (83%)	7 (18%)
CS	35 (88%)	5 (12%)
HIA	34 (85%)	6 (15%)
Has any one of the following been removed, with the approval of the Board, over the last 12 months?		
CFO	3 (8%)	37 (93%)
CS	1 (3%)	39 (97%)
HIA	1 (3%)	39 (97%)
Which of the following qualifications does the CFO of your Organization hold?		
Member of a recognized body of professional accountant	30	
Graduate from a recognized university and 5 years of experience	13	
None of the above	2	
Which of the following qualifications does the CS of your Organization hold?		
Member of body of professional accountants/corporate secretaries	22	
Lawyer or a recognized university graduate with 5 years experience	20	
None of the above	0	
Do CFO & CS attend all the meetings of the Board?	40 (100%)	

4.2.4 Corporate and Financial Reporting Network

All companies, who responded, declared that quarterly un-audited financial statements/ accounts are circulated to the shareholders after approval by the Board of Directors within 30 days. Similarly, all companies averred that half yearly accounts are subjected to a limited scope review before approval by the Board of Directors and circulated to the shareholders

Apart from one company, all other companies, who responded, stated that annual accounts are circulated not later than four months after the closing of the financial year. The only company that could not adhere to this provision faced delays due to merger petition filed in the court.

Furthermore, all companies also declared that the required information was circulated to the stock exchange immediately after approval of the accounts by the Board. None of the company that responded had issued any capital to the public during the last one year, although there were companies that issued bonus shares.

38 companies (95%) stated that the companies' statement of Accounts is signed by the CEO and the CFO after approval and authorization by the Board and before circulation to the shareholders. Companies who responded in negative had either signatures of CEO and a Non-Executive Director or those of Chairman, CEO and a Director on the Accounts statement instead of CEO and CFO.

37 companies (93%) responded that disclosure of interest requirements as laid out in the Code are being met. Two companies stated that this clause is not applicable to them. Only one company out of 40 responded that either external auditors or any partner of the firm or his/her spouse or minor children held any position in the shares of the company and these shares were divested. All other companies stated that there was no such conflict of interest and therefore no shares had to be divested due to such conflict of interest.

Table 4.6: Responses Regarding Corporate and Financial Reporting Network

	YES	NO
Does the Directors' report contain all the statements as required under Sec 236 of Company's Ordinance 1984 & as per guidelines under clause (xiv) of Code of Corporate Governance?	40 (100%)	
Are quarterly un audited financial statements circulated to the shareholders after approval by the BOD within 30 days?	40 (100%)	
Are half yearly accounts subjected to a limited scope review before approval by the BOD and circulated to the Shareholders?	40 (100%)	
Are annual accounts circulated not later than four months from the closing of the financial year?	39 (97%)	1 (3%)
Does your company circulate the required information to the Stock Exchange immediately after approval of the Accounts by the BOD?	40 (100%)	0
Are all your statement of Accounts signed by the CEO & CFO, after approval & authorization by the BOD before circulation to the Shareholders?	38 (95%)	2 (5%)
Regarding 'Disclosure of interest by a Director Holding Company Shares', are the requirement of clause (xxvi) of CCG being met by the Company?	37 (93%)	3 (7%)
Do your external Auditors or any partner of the firm or his/her spouse or minor children hold any position in the shares of your company?	1 (3%)	39 (N/A) (97%)
If the external Auditors held any shares in your Company before their appointment, have those shares been divested? (N/A if not applicable)	1 (3%)	39 (N/A) (97%)
If any share capital has been issued over the last 12 months, how much of it was offered to the general public?		40 (N/A) (100%)

4.2.5 Audit Committee

Most of the companies established Audit Committees during July 2002. Some of the multinationals reported that audit committee in their organizations was established in the early 1990s whereas the earliest audit committee was reported to have been established in 1982.

Majority of the committees reported that the audit committee consisted of 3 members, comprising one Executive Director and two Non-Executive Directors.

38 out of 40 companies, amounting to 95%, reported that the Chairman of the Audit Committee was from the Non-Executive Directors whereas only 2 companies reported that the Executive Director was the Chairman of the Committee.

In 35% of the companies (14), Internal Auditor was the Secretary of the Audit Committee whereas 12 companies (30%) stated that the Company Secretary of the organization was the Secretary of the Audit Committee. Similarly, 14 companies (35%) stated that neither Company Secretary nor Internal Auditor was acting as the Secretary of the Committee.

Only 10% of the companies (4) stated that neither CFO nor CEO attended the meetings of the Audit Committee. On the other hand, 48% of the companies (19) stated that the CFO attended the meeting whereas 43% of the companies (17) responded that both CEO and CFO attended the meetings. In case of CEO attending the meeting, it was the Audit Committee who had invited him to attend the meeting.

32 out of 40 companies (80%) responded that the Audit Committee met the External Auditors without the CFO and the Head of Internal Audit. 20% of the companies stated that the Audit Committee has not met the External Auditors without CFO and the Head of Internal Audit. These companies were in the process of arranging such meeting.

35 companies (88%) stated that the Audit Committee met the HIA and other members of the Internal Audit function without the CFO and the external auditors.

On average 7 Internal Audit Reports, in addition to review of financial statements, were presented to the Audit Committee by the Head of Internal Audit. Most frequently cited number was 1 additional internal audit report presented to the Audit Committee by the Head of Internal Audit.

Table 4.7: Responses Regarding Audit Committee

	AVERAGE	
Has an Audit Committee been established in your Company, if so when? (Please state month/year)	July 2002	
How many Directors are members of the Audit Committee?		
Executive	1	
Non-Executive	2	
Is the Chairman of the Committee an		
Executive Director	2 (5%)	
Non-Executive Director	38 (95%)	
Who acts as the secretary of the Committee?		
Internal Auditor	14 (35%)	
CS	12 (30%)	
Other	14 (35%)	
How many meetings of the Audit Committee took place during the last twelve months?	4 (Average)	
Did CEO & CFO also attend the Committee meetings?		
No	4 (11%)	
Yes	19 (47%)	
CFO	17 (42%)	
During the last 12 months:		
Did the Committee meet the External Auditors without CFO and the Head Of Internal Audit?	32 (80%)	8 (20%)

Did the Committee meet the HIA and other members of the Internal Audit function without CFO and the external Auditors?	35 (88%)	5 (12%)
In addition to review of financial statements, how many Internal Audit Reports were presented to the Audit Committee by the Head of Internal Audit?	7 (Average)	

4.2.6 Internal Audit Function

On average in-house audit department of an organization has 3 members, although most of the companies reported that the in-house audit department consisted of 1 member only.

29 out of 40 companies (73%) responded that the Head of Internal Audit reported to CEO whereas 3 companies stated that the Head of Internal Audit reported to the CFO. Moreover, 8 companies (20%) stated that the Head of Internal Audit reports to Audit Committee. 8 companies (20%) stated that the internal audit function is outsourced whereas 32 companies (80%) responded that the internal audit function is not outsourced.

Out of the 8 companies who had stated that the internal audit function is outsourced, 3 responded that the person responsible for liaison in the company is the Head of Internal Audit whereas CFO was the person responsible for liaison in 4 companies. Company Secretary acted as the liaison officer in only one company. All companies responded that the Head of Internal Audit had direct access to the Chairman of Audit Committee.

95% of the companies (38) responded that Internal Audit Reports are provided to the External Auditors whereas only 2 companies responded that the reports are not provided to the External Auditors. 33 companies (83%) stated that the auditors have reported significant matters to the Audit Committee whereas the remaining 17% stated that no significant matters were reported by the auditors to the Audit Committee.

Table 4.8: Responses regarding Internal Audit Function

If there is an in-house Audit Department, how many members does it have?	3 (Average)	
Who does the Head of Internal Audit (HIA) report to?		
CEO	29 (73%)	
CFO	3 (7%)	
Audit Committee	8 (20%)	
Is the Internal Audit function outsourced fully/partly?	8 (20%)	32 (80%)
In case the function is outsourced, who is the person responsible for liaison in the Company?		
HIA	3	
CFO	4	
CS	1	
Does the HIA have direct access to the Chairman Audit Committee?	40 (100%)	0
Are Internal Audit Reports provided to the External Auditors?	38 (95%)	2 (5%)
Over the last 12 months, have the Auditors, reported any significant matters to the Audit Committee?	7 (17%)	33 (83%)

4.2.7 External Auditors

All companies declared that the External Auditors have been appointed in conformity with the guidelines stated in the Code of Corporate Governance.

21 companies (53%) stated that separate Management Consultants have been appointed to advise on matters other than audit. 47% of the companies (19) reported that separate Management Consultants have not been appointed.

83 % of the companies (33) reported that after the last audit a management letter was provided to the BOD within 30 days from the date of the Audit Report.

95% of the companies responded that the Management Letter was discussed at the Audit Committee and the response was sent to the Auditors.

97% of the companies responded that a partner representing the External Auditors attended the last General Meeting when the accounts were discussed.

Table 4.9: Responses Regarding External Auditors

	YES	NO
Have your External Auditors been appointed as per guidelines contained in clause (xxxvii-xxxix) of CCG?	40 (100%)	0
Have you appointed separate Management Consultants to advise on matters other than audit?	19 (48%)	21 (53%)
After the last annual audit, was a Management letter provided to the BOD within 30 days from the date of the Audit Report?	33 (83%)	7 (17%)
Was the Management letter discussed at the Audit Committee /BOD and response was sent to the Auditors?	38 (95%)	2 (5%)
Did a partner representing the External Auditors attend the last annual General Meeting, when the when the Accounts were discussed?	39 (97%)	1 (3%)

4.2.8 Compliance with CCG

All companies declared that the company has published and circulated a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance. All companies also declared that the company has ensured that the statement of compliance with the best practices of corporate governance is reviewed and certified by statutory auditors, where such compliance can be objectively verified, before publication by listed company.

Table 4.10: Responses Regarding Compliance with the Code

	YES	NO
Has your company published and circulated a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance?	40 (100%)	0
Has your company ensured that the statement of compliance with the best practices of corporate governance is reviewed and certified by statutory auditors, where such compliance can be objectively verified, before publication by listed companies?	40 (100%)	0