

Report on the Survey on Board Practices of Public Sector Companies in Pakistan

May, 2016



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Introduction

The Pakistan Institute of Corporate Governance (PICG) was set up in 2004 as a not-for-profit company charged with promoting good corporate governance practices in Pakistan and is involved in research on corporate governance structures, processes and policies, board diversity and concentrated ownership structures; corporate governance training and education; raising awareness; and publishing guidelines and other resource material.

State-owned enterprises (SOEs) are generally set up by the government to partake in developmental, social and commercial activities whilst taking into account the overall interest of the public at large. These enterprises function at both Federal and Provincial levels in Pakistan and are monitored by their respective line ministries, however, consolidated information is publically available for only the Federal SOEs¹. Sound Corporate Governance and increased transparency at the enterprise-level therefore becomes an essential prerequisite to ensure the integrity and credibility of such enterprises and improve the overall accountability and image of SOEs. The overall structure, independence and functioning of the Board of such enterprises, with minimal interference, thus becomes key to ensure the application of good governance policies and procedures.

Consequently, for the very purpose of establishing a framework of good governance, the Securities and Exchange Commission of Pakistan (SECP) issued the Public Sector Companies (Corporate Governance) Rules 2013 (Rules), in August 2013. The Rules were based on the Code of Corporate Governance 2012 issued by the SECP (now embodied in the Pakistan Stock Exchange Rule Book), keeping in mind Guidelines on Corporate Governance of State Owned Enterprises issued by the OECD in 2005.² The Rules provide a regulatory mechanism for improving the governance of Public Sector Companies (PSCs) and enhance board effectiveness and empowerment through a range of measures such as: encouraging a majority of independent non-executive directors on the boards, separating the role of the CEO and Chairman, increasing accountability and improving the board's capacity for decision making, appointment of board members and CEO subject to the fit and proper criteria laid down by the SECP, appointment of CEO on the recommendation of the board of directors, performing an annual evaluation of the board which is to be submitted to the government and encouraging transparency through reporting and inclusion of minority shareholders.

¹ Refer http://finance.gov.pk/publications/State_Owned_Entities_FY_2013_14.pdf for the report "State Owned Enterprises (SOEs) Performance Review FY 2013-14" issued by the Ministry of Finance in April 2016.

² These have now been updated and issued by the Organisation for Economic Co-operation and Development (OECD) in 2015

This Survey

PICG has been involved in the development and review of the Rules since February 2008 and a member of the task force set up by the Ministry of Finance. Given that a few years have passed since its issuance, PICG Research Team decided to conduct this survey to get an overview and assess the extent of awareness and implementation of the Rules; understand issues, if any, being faced by PSC's in adopting the Rules in their entirety; and review the resultant impact of compliance on board practices of PSC's.

The survey was designed in the form of a questionnaire and sent to executives of PSCs to obtain direct feedback from them. PICG requested the survey to be filled by either the Chairman, CEO or a Board Member of the company.

In order to get a broad representation of general practices amongst PSCs no distinction was made with respect to legal status or industry of PSCs while sending out the survey to 182 PSC's monitored by the Federal Government. We received responses from 17 PSC's, out of which 1 PSC stated that it was not required to follow the Rules on account of having been incorporated under a Special Act and another 2 claimed not to be PSC's at all. None the less, the responses received covered both large and small scale PSC's, as well as PSC's from various sectors such as Banking & Financial Services, Promotional & Advocacy, Power & Energy, Oil & Gas etc., and even a couple with foreign affiliation, thus enabling us to gain an overview of board practices amongst a varied spectrum of PSC's. We would like to place on record our appreciation for their invaluable contribution to this survey.

All information has been tabulated and analyzed based solely on responses received. While all possible care has been taken to compile the results, the possibility of any unintentional error cannot be ruled out. Kindly inform the Research Team of any errors noticed on info@picg.org.pk

Research Team – PICG

May 16th, 2016

Executive Summary

Public Sector Companies make up a considerable portion of our country's business and their success is absolutely vital for the success of Pakistan's economy. According to the Rules a PSC is a company, whether public or private, which is directly or indirectly controlled, beneficially owned or one in which not less than fifty percent of the voting securities or voting powers are held by the Government or in respect of which the Government has otherwise power to elect, nominate or appoint majority of its directors.

More than 90% of the directors on the average PSC board are either non-executive or independent directors, with the Chief Executive Officer (CEO) being the only executive director. While this is encouraging and in line with the requirement of the Rules of having 40% of the directors as independent in the first 2 years, and working towards a majority by the end of the subsequent 2yrs, gender diversity on the other hand is very low with only a mere 4.8 % of female directors on board.

A significant 46% percent of directors are those who are representing the government. Boards composed of mainly government representatives generally lack the objectivity and skills vital to well-functioning boards. Often appointed to pursue policy goals and in some cases to compensate shortage of appropriately skilled directors from the private sector, government appointed directors may lack the independence to become effective board members.

The positions of the Chairman and CEO were unanimously held by two different individuals. The Chairpersons in our sample are largely independent, with the remaining being non-executives – a trend which greatly contributes to the impartiality of boards.

The CEO was appointed by the government in almost all cases including those appointments based on the board's recommendation. Respondents unanimously said that the Board was responsible for assessing the CEO's performance, followed by a strong majority that said that the board also reviewed succession plans for the CEO, and that the CEO was appointed for a fixed term.

Fees of non-executive directors for attending board meetings and board committee meetings generally remained at less than PKR 30,000 and, in a few cases, no fees were paid at all. Others stated that fees were paid only for board meetings and not committee ones.

While a majority held director Orientation Sessions for board members, the same was not the case for the Director's Training Program (DTP) with only 43% having conducted them. Furthermore, 21% had neither Orientation Sessions nor DTP's conducted.

The majority of PSC's have Board Evaluation Mechanisms in place; out of these, all of them evaluate the board as a whole, however, only half of them cover board committees, and another half evaluate their independent directors. A sizeable minority stated that such mechanisms did not exist in their respective organizations.

79% discussed company strategy annually, however, some stated that it was never discussed, possibly indicating the influence of the government for strategic decision making.

All PSCs in our survey have Audit and Human Resource Committees; a majority have the Procurement and Nominations Committees; followed by just under half that have the Risk Management Committees, respectively. 21.4% of PSCs have all 5 committees as advised under the Rules.

In almost all cases, Audit Committees are chaired by independent directors, but where that is not the case, the Chairman is a non-executive (not being the Chairman of the board). Also, an Internal Audit mechanism was in place in over 90% of the companies.

92% of Company Secretaries met at least one of the three legal qualification requirements (as laid down in Rules), with the largest number of Company Secretaries holding a Master's degree or being law graduates from an HEC recognized university with at least 5 years of relevant experience.

While 64% have their annual reports available on the company's official website, this was not the case in the smaller- scale PSC's.

PSC's stated 'having dependable management that takes ownership' as the most important factor in the contribution to operational efficiency, followed by an equal number stating that transparency in appointment of Board members and non-interference of respective ministries play an important role. Having competent and professionally qualified board members was also cited as an important factor.

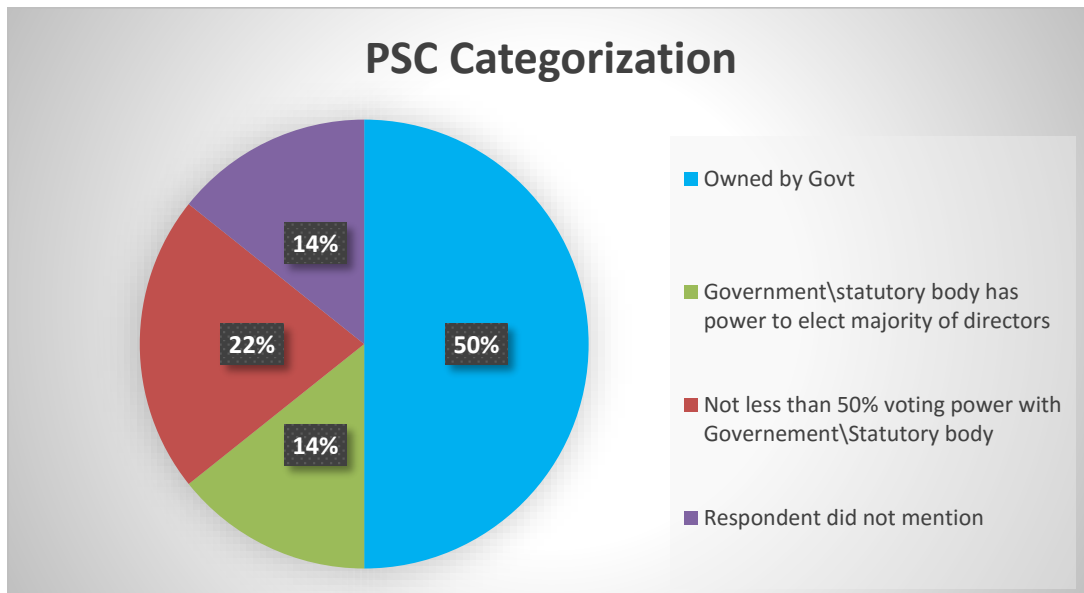
There is an overall consensus that the Rules facilitate governance and sustainable growth of PSC's. However, some PSC's faced restraints in application of the Rules due to lack of orientation of their board members, difficulty in gaining acceptance of board members for formulation of policies required under the Rules, inadequate number of independent directors, lack of empowerment of board on key issues and a general lack of ownership and accountability.

Various ideas were provided for reforms, mechanisms and policies that could be enforced to ensure greater sustainability amongst PSC's in Pakistan. The most common ones noted being the experience and competency of directors, merit based selection of directors to the board, accountability and transparency in processes and immunity from political interference. Furthermore, the role of SECP and other related government agencies was highlighted in order to implement the Rules in their true spirit to ensure improved governance of PSC's.

Detailed Analysis

Categorization of respondent PSC's

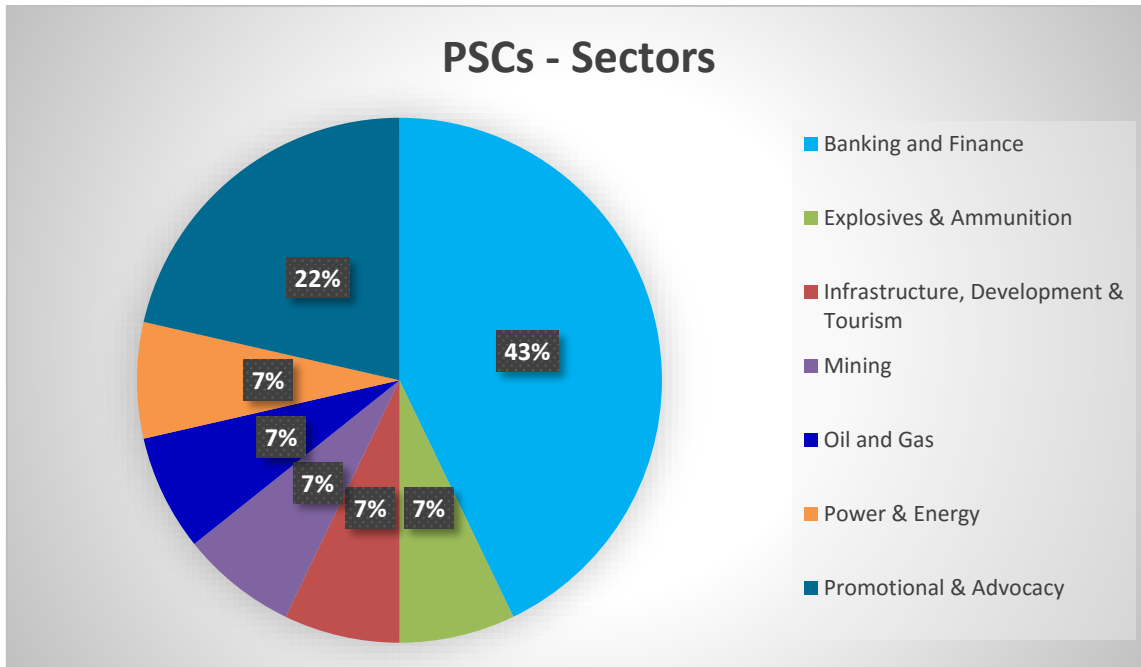
a. Ownership/ control



Comments:

- No response from those under Special Acts.

b. Sectors³



Comments:

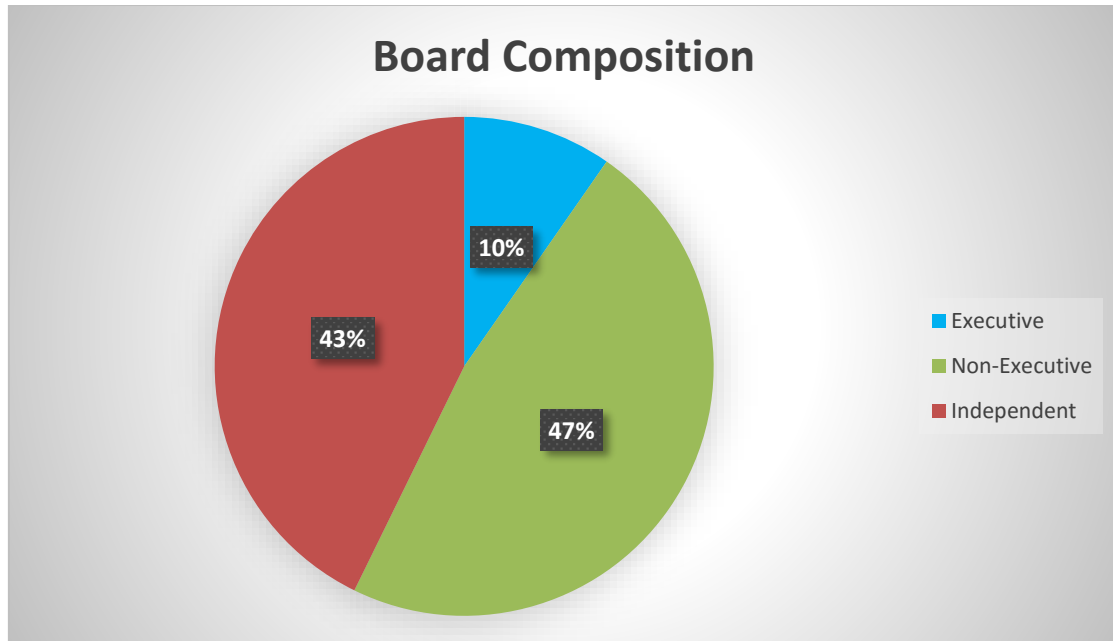
- The above sectors fall under the following Ministries of the government:
 - M/o Finance
 - M/o Industries and Production
 - M/o Inter Provincial Coordination
 - M/o Water & Power
 - M/o Commerce & Textile Industry
 - M/o Petroleum & Natural Resources

³ Sector classification taken from list provided by the *Economic Reforms Unit*, Ministry of Finance.

Board composition

1) Please provide the number of directors on your Board that are:

Executive	
Non-Executive	
Non-executive Independent	



Comments:

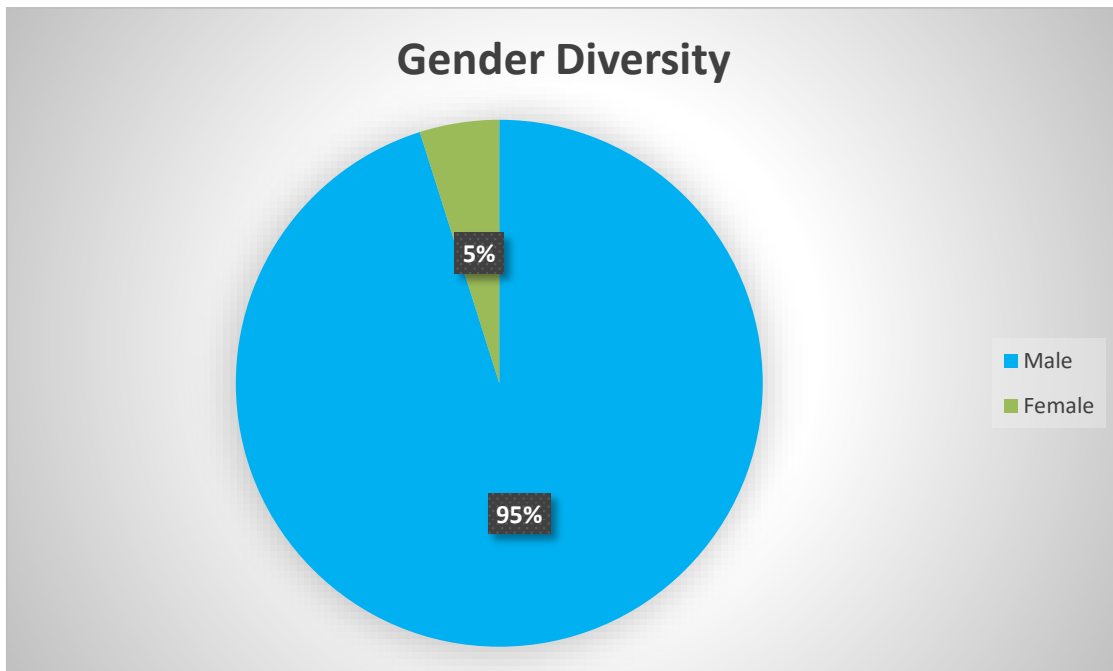
- i. On average the number of directors on the board of PSC's is 9 -- with 4 executive and 4 independent directors.
- ii. The number of directors on PSC boards in our sample ranged from 6 to 16.
- iii. 57 % of PSC's had 40% or more independent directors as required by Rule 3(2).
- iv. 21.4% did not have any independent directors.

Diversity

2) Please indicate the number of Board members that are:

Female directors	
Directors representing the Government	

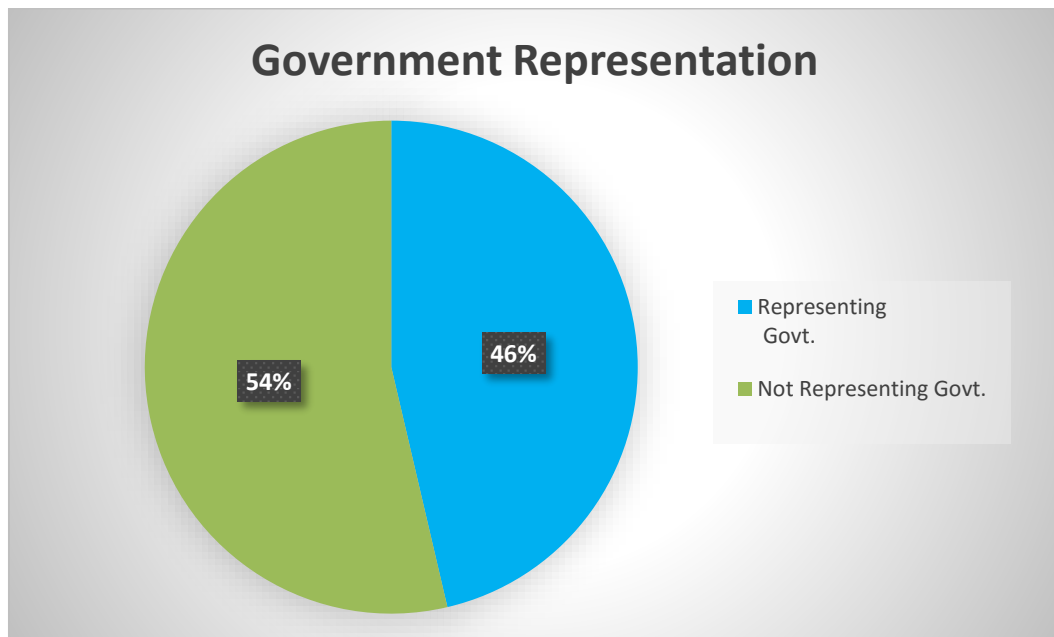
a. Gender



Comments:

- i. Only about 1/5th of the respondent PSC's (ie.21.4%) had females on their boards. However, the ratio of females: male did not exceed 30% in any one case, or 5% in aggregate.
- ii. A slightly better ratio was noted in the Promotions & Advocacy sector, as opposed to the other sectors.
- iii. The lowest female: male ratio on boards of PSC's was observed in the Financial & Manufacturing Sectors.

b. Government representatives



Comments:

- i. Number of directors representing the government range from 0-10
- ii. Approximately 1/5th of the PSC's do not have any government representative on board. These are the relatively smaller-scale PSC's.

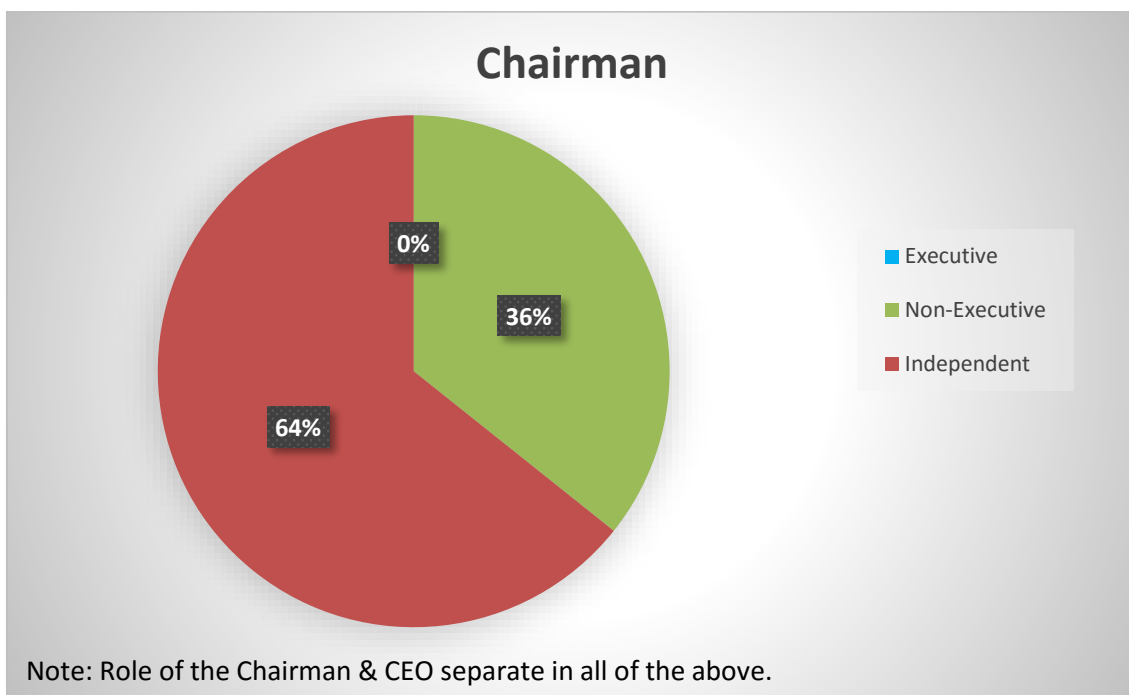
Chairman

3) Are the positions of the Chief Executive Officer (CEO) and Chairman held by different persons?

YES NO

4) If YES, is the Chairman (Tick one)

Executive	<input type="checkbox"/>
Non-Executive	<input type="checkbox"/>
Non-Executive Independent	<input type="checkbox"/>

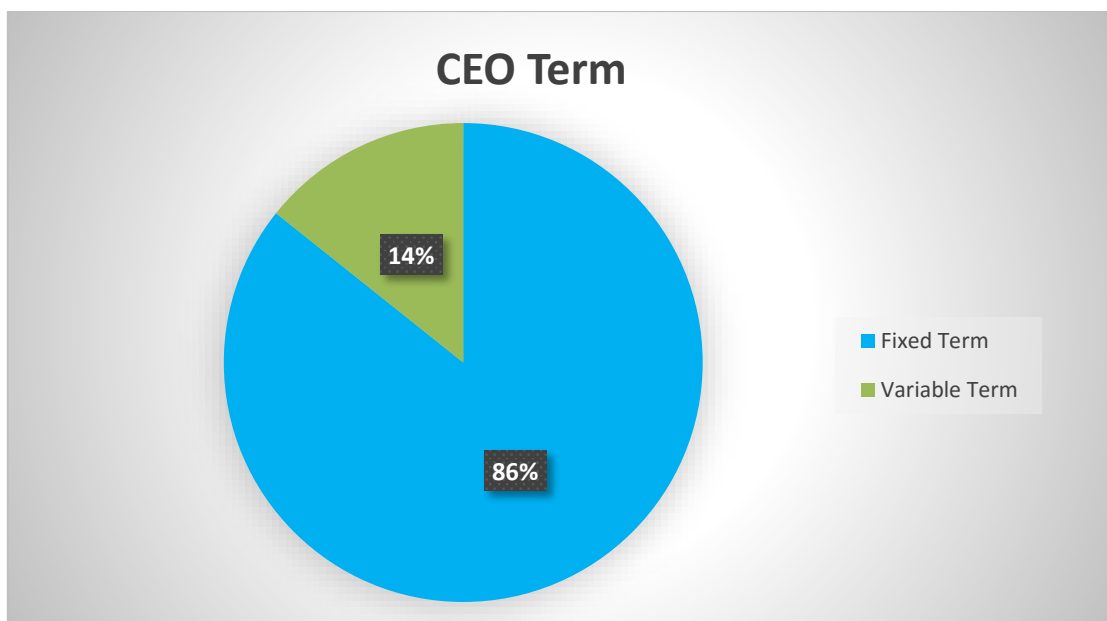
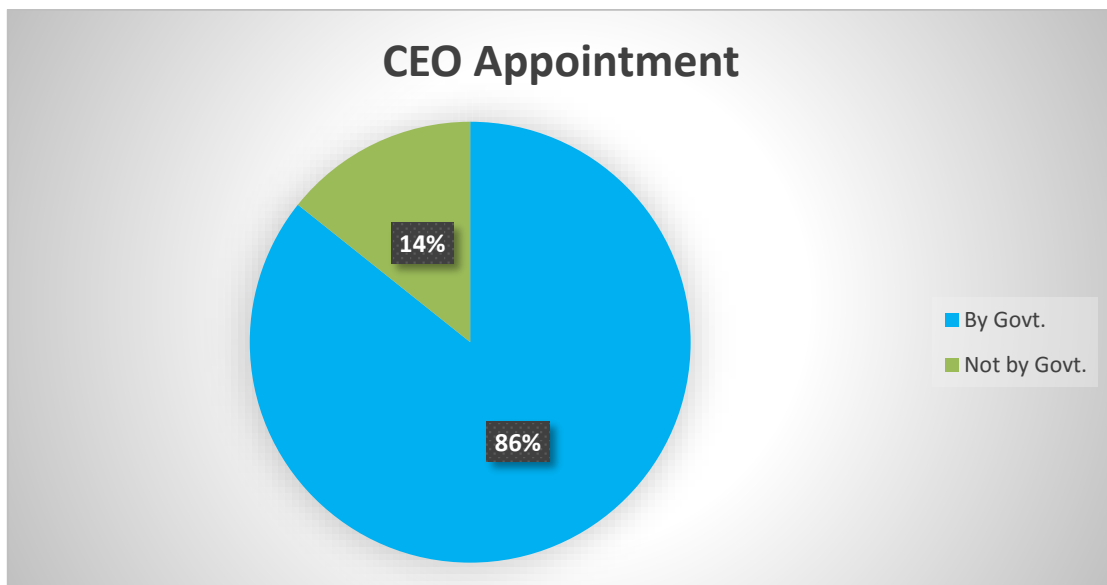


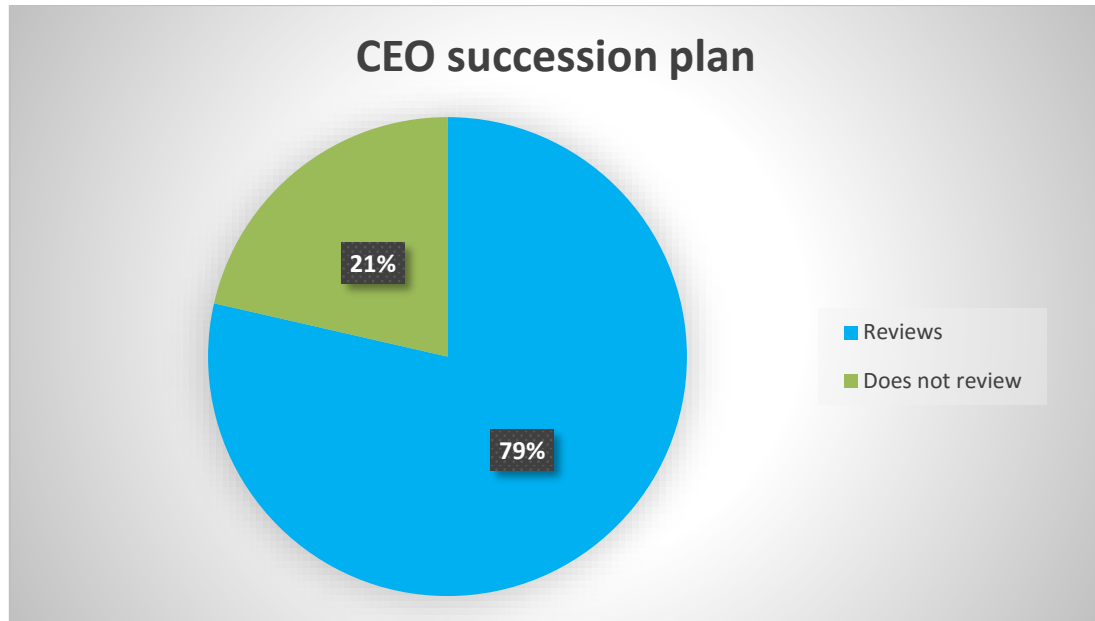
Comments:

- i. 100% of PSC's have separate CEO's and Chairman
- ii. None of the Chairmen are executive directors
- iii. The majority of Chairmen are independent

Chief Executive Officer

- 5) Is the CEO appointed by the Government?
YES NO
- 6) Does the Board assess the performance of the CEO?
YES NO
- 7) Does the Board review succession plan for the CEO?
YES NO
- 8) Is the CEO always appointed for a fixed term?
YES NO





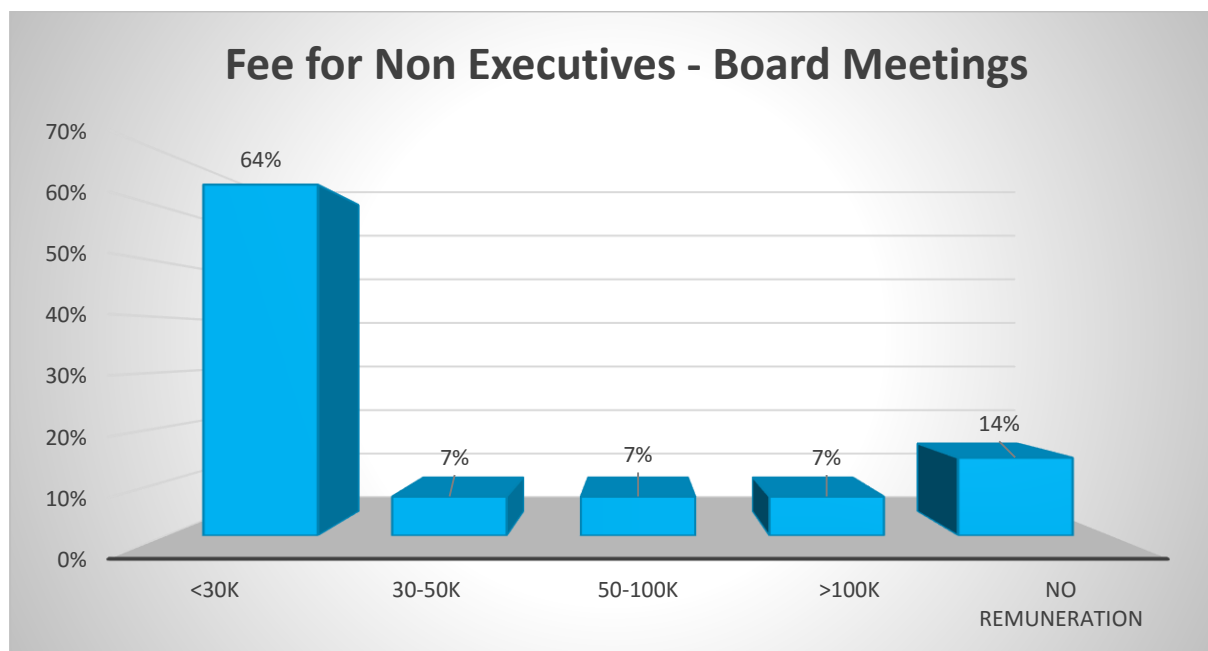
Comments:

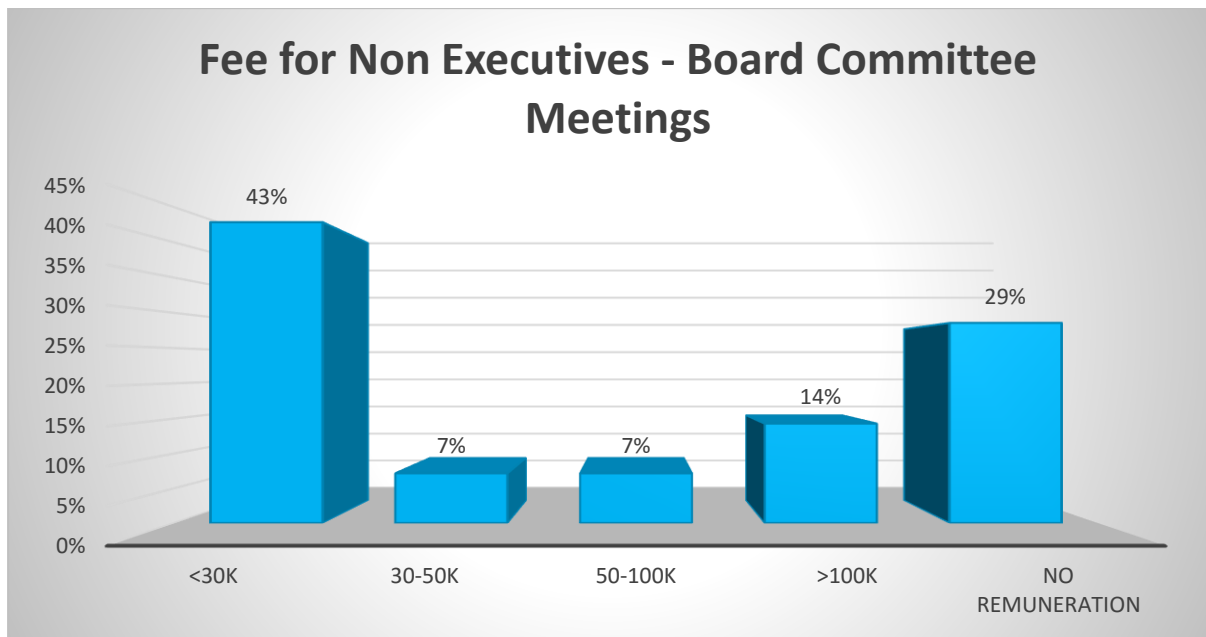
- i. Majority of CEO's appointed by government.
- ii. Government appointed CEO's include those appointed by the government on the recommendation of the board.
- iii. 100% of PSC's state that CEO performance is assessed.
- iv. PSC's that have not reviewed succession plans are from the Financial services sector.

Fees- Non-Executive Directors

9) Please tick the relevant range of meeting fee paid to each **Non-Executive** director for:

Range (in Rupees)	For Board Meetings	Board Committee Meetings
a) <30,000		
b) 30,000- 50,000		
c) 50,000-100,000		
d) >100,000		
e) No remuneration		





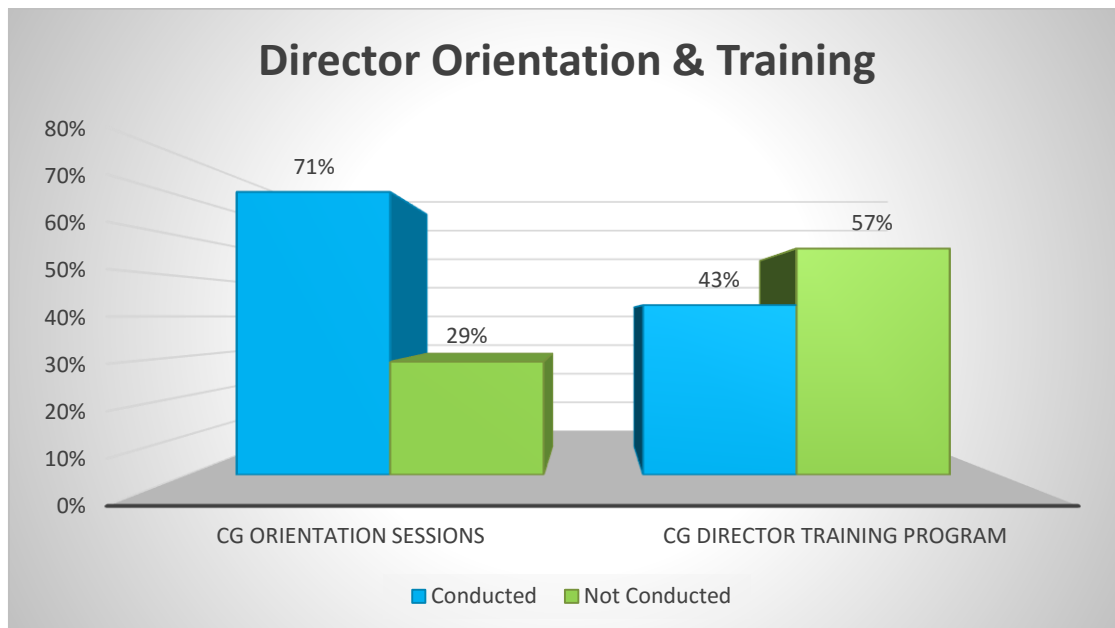
Comments:

- i. Majority fall under lowest range of fees (ie. below PKR 30,000)
- ii. 14 % said that no fees are paid. These PSC's are from the Promotional and Advocacy Sector under the Ministry of Industries and Production.
- iii. 28.6% PSC's did not compensate directors for participation in Board Committees-- out of these 50% were amongst those that did not compensate their non-executive directors on the Board either.

Professional Development

10) Are the following conducted for Board members in your organization

Corporate Governance Orientation Sessions	
Corporate Governance Director's Training Program (DTP)	



Comments:

- i. More orientations held as opposed to DTP
- ii. 21.4 % stated that neither orientation nor DTP carried out.

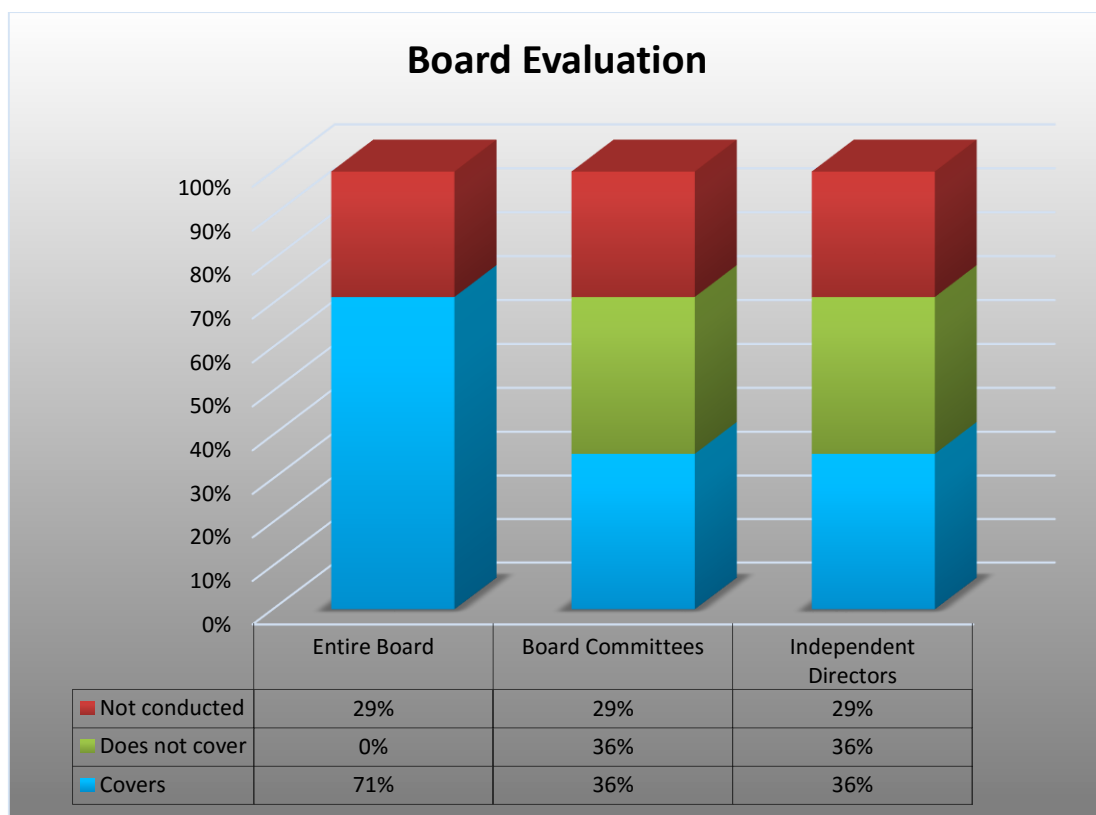
Evaluation

11) Does your organization have a Board Evaluation mechanism in place?

YES NO

12) If YES please indicate if the evaluation covers the following (You may tick more than one):

Entire Board	
Board Committees	
Independent Directors	



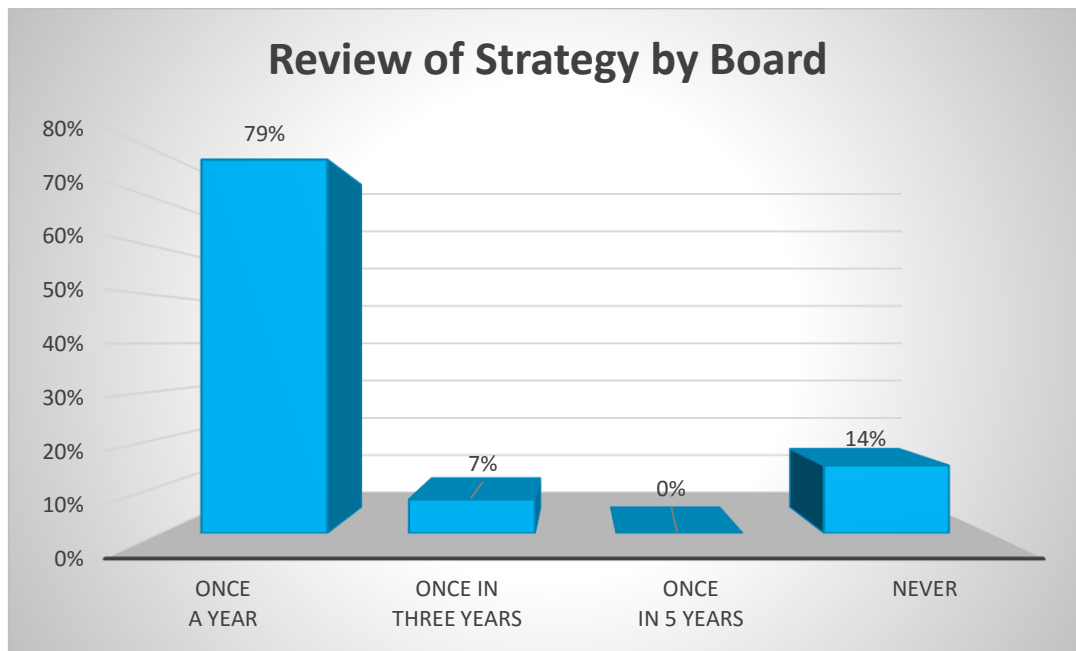
Comments:

- i. 29% of PSC's do not carry out evaluation of the board, its committees or individual directors.
- ii. Out of the 71% that did carry out evaluation, 100% carried it out for the board as a whole, whereas, 50% also did it for the committees. Further 50% evaluated their individual directors as well.

Strategy

13) How often does the Board discuss the company's strategy? (Tick one)

Once a year	<input type="checkbox"/>
Once in Three years	<input type="checkbox"/>
Once in Five Years	<input type="checkbox"/>



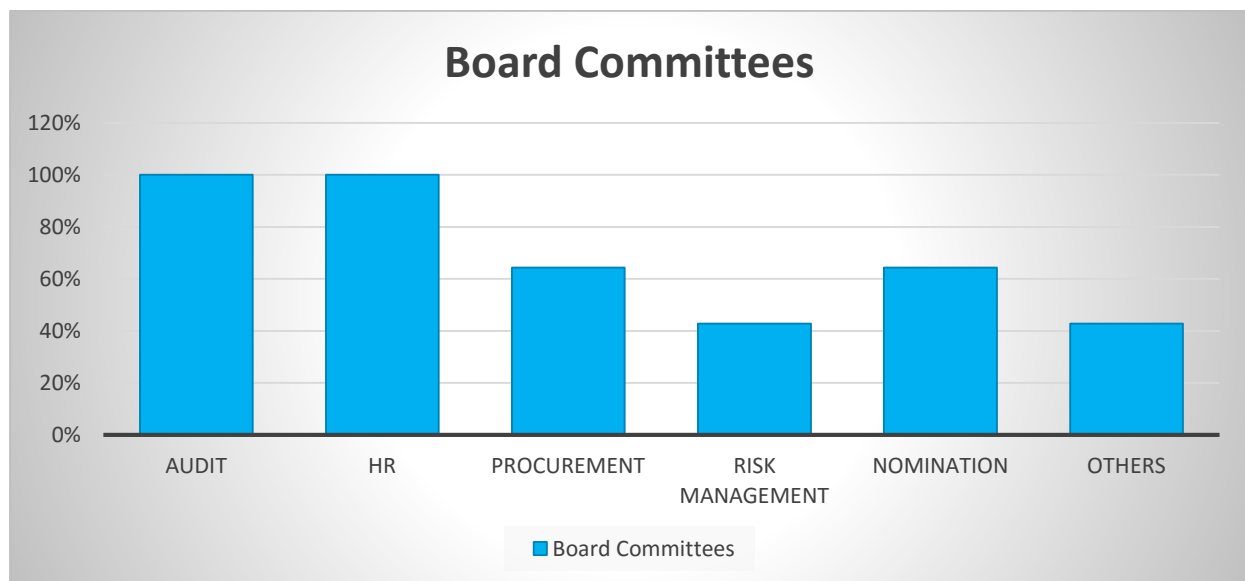
Comments:

- i. Majority of PSC's review strategy annually
- ii. 14% state that it is never discussed.

Committees

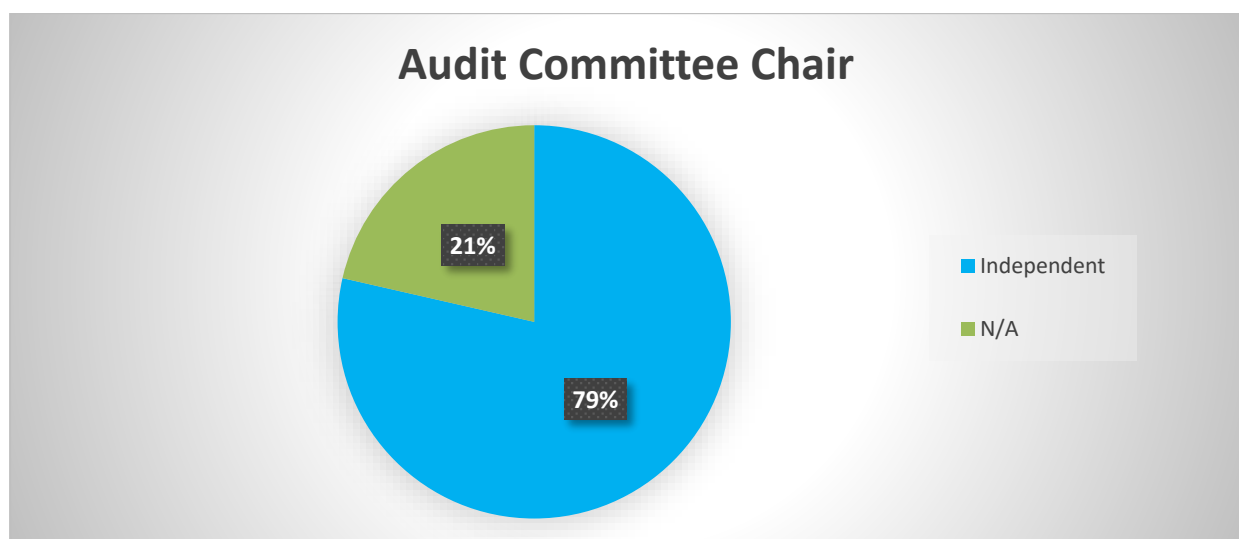
14) Please indicate the Board Committees that currently exist in your organization (You may tick more than one):

Audit Committee	
Human Resources Committee	
Procurement Committee	
Risk Management Committee	
Nomination Committee	
Others (Please state)	



15) Is the Audit Committee of your Board chaired by an Independent Director (who is not Chairman of the board)?

YES NO



Comments:

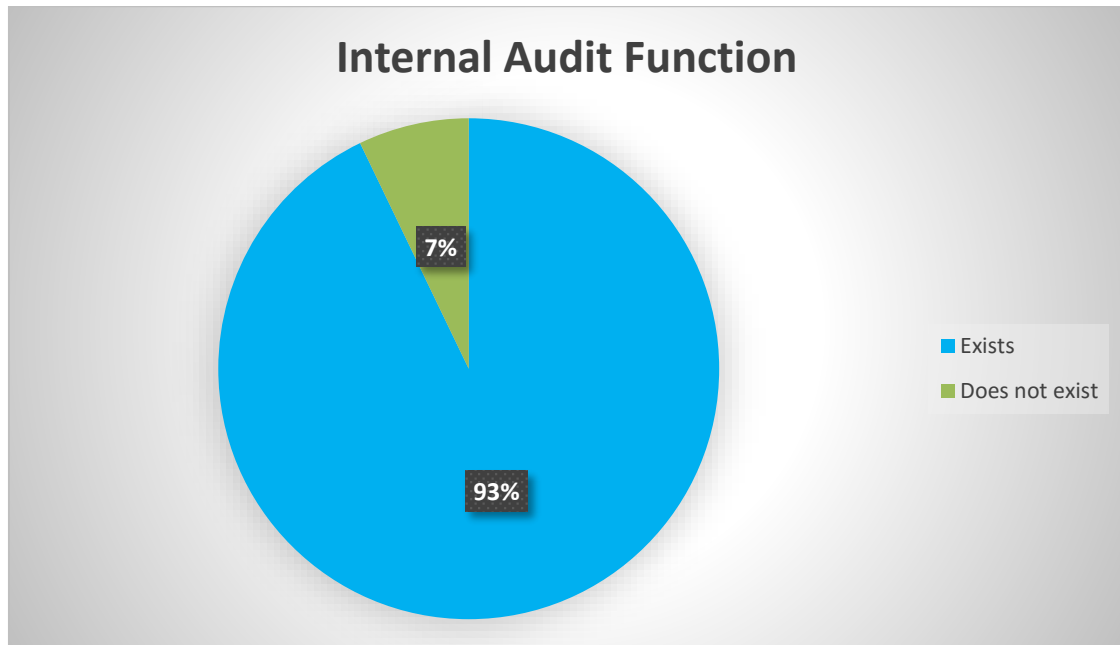
- i. All PSCs have an Audit Committee and HR Committee
- ii. 21.4% have all 5 committees mentioned in the PSC Rules. Out of these 2/3rd are from the Banking and Financial Services Sectors and 1/3rd represent the Oil and Gas sector.
- iii. Other committees mentioned by respondents also included the Investment and Executive Committees.
- iv. Chairman of the Audit Committee is not an independent director in those cases where there is no independent director on the board as well.
- v. The Chairman of the Audit Committee is not the same as the Chairman of the Board, even in situations where there is no independent director.

Internal Audit

16) Does your organization have an Internal Audit mechanism in place?

YES

NO



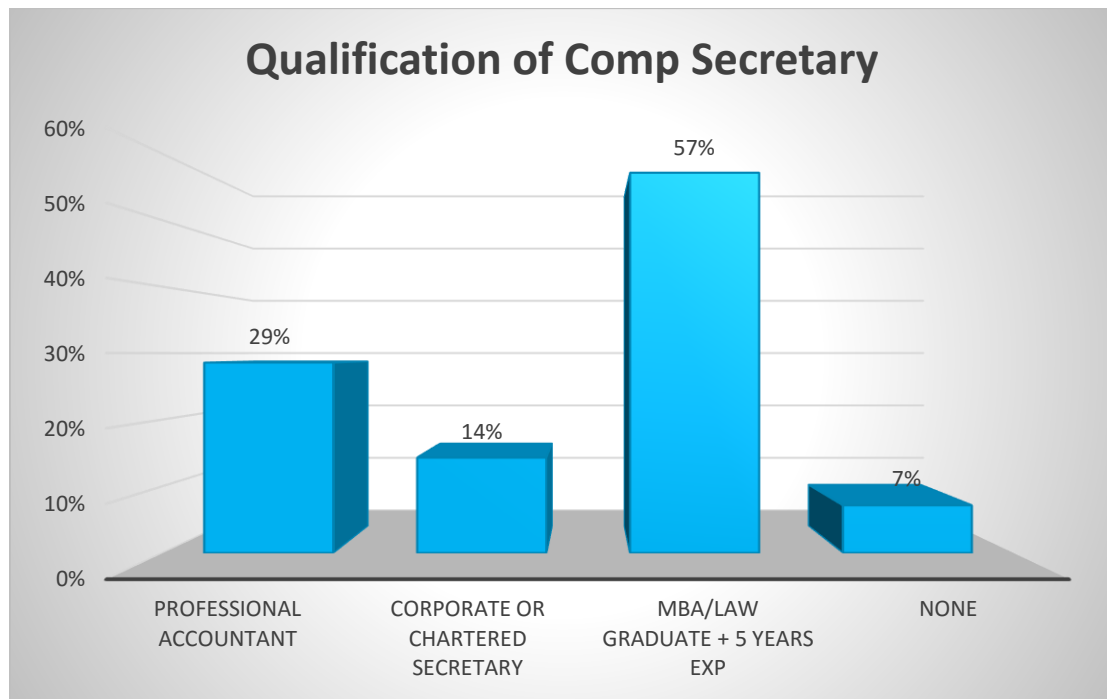
Comments:

- i. The PSC where the Internal Audit Function does not exist is one of the smaller scale PSC's

Company Secretary

17) Please indicate whether the Company Secretary of your organization is

A member of a recognized body of professional accountants;	
A member of a recognized body of corporate or chartered secretaries; OR	
A person holding a master degree in business administration or commerce, or being a law graduate from an HEC recognized university with at least five years relevant experience	



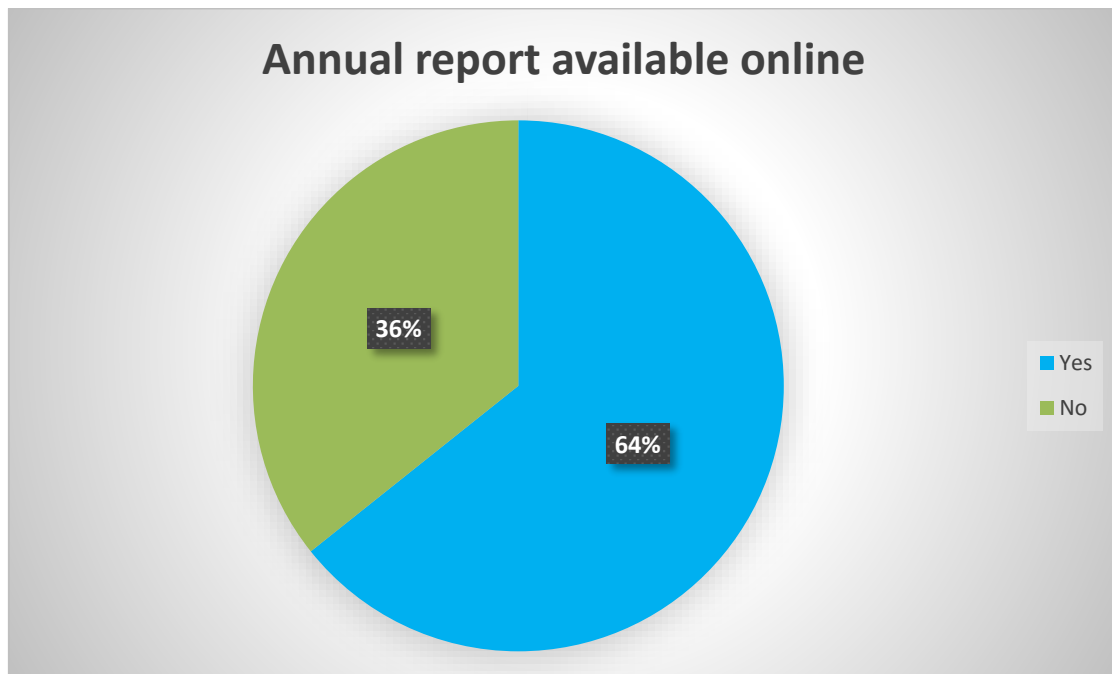
Comments:

- i. 7% had more than one qualification

Annual report on website

18) Is the annual report available on the company's official website?

YES NO



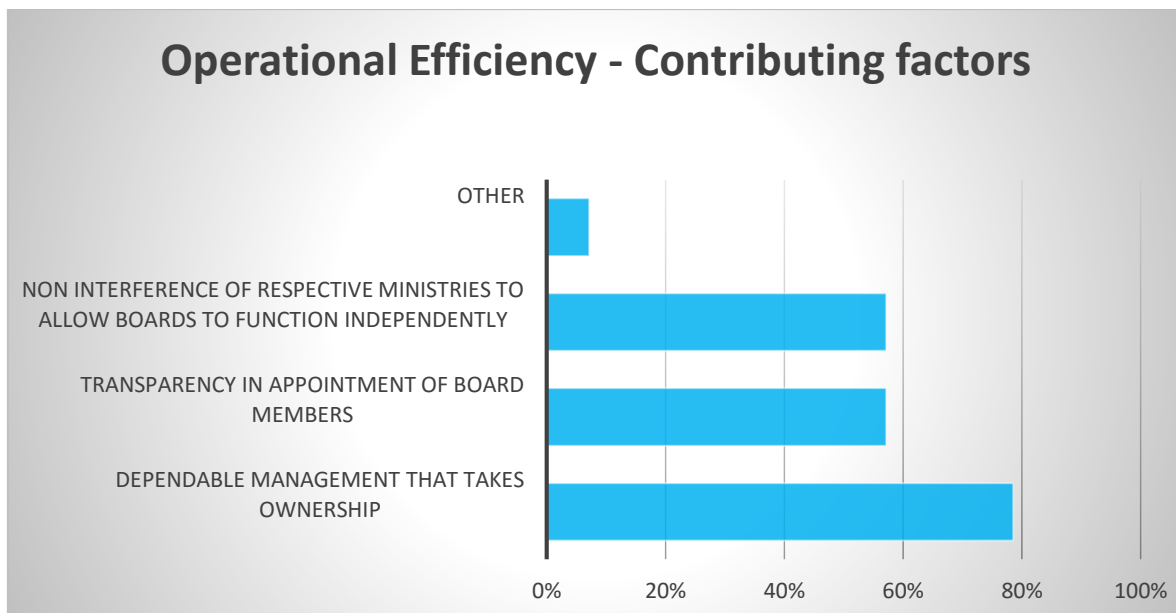
Comments:

- i. 35.7% do not have their Annual Reports on their website. These consists mainly of the smaller scale PSC's

Operational efficiency of PSC's

19) Select the 2 most important factors which, in your opinion, will most contribute to the operational efficiency of PSCs in Pakistan:

Dependable management that takes ownership	
Transparency in appointments of Board Members	
Non-interference of respective ministries to allow boards to function independently	
Other (Please state)	



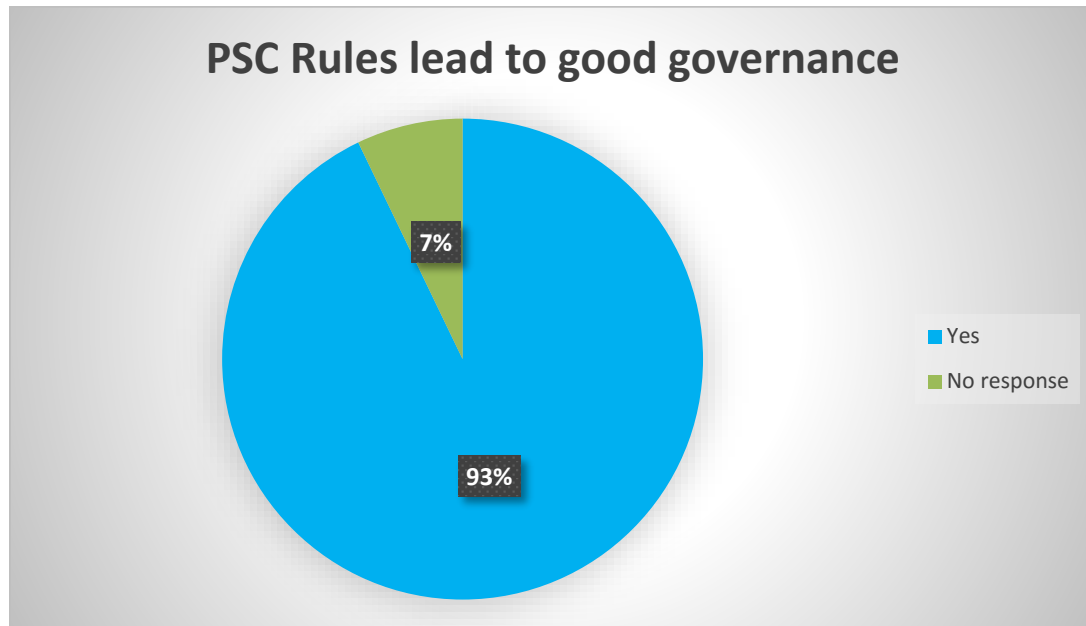
Comments:

- i. 78.6 % stated that dependable management that takes ownership is key to operational efficiency
- ii. Transparency in appointments of the board and non-interference of respective ministries are the next factors considered important, by an equal number of respondents.

PSC Rules – Good Governance

20) Do you feel that the Public Sector Companies (Corporate Governance) Rules, 2013 facilitate good governance & sustainable growth of your organization?

YES NO



Comments:

- i. Those who responded unanimously agreed that the Rules facilitated good governance.

Implementation – issues faced

21) What problems do you face (if any) in the application of these Rules?

The following issues were faced by some in application of the Rules:

- Lack of orientation of board members.
- Difficult to gain acceptance of board members for policies drafted under SRO-180.
- Inadequate number of independent directors as required under Rules.
- Lack of empowerment of board on key issues.
- Lack of ownership and accountability.
- Absence of reward and punishment system / Poor HR policies

Comments:

- i. The last point does not necessarily relate to the application of Rules, however, is required for good governance.

Recommended Reforms & mechanisms for growth of PSC's

22) In your opinion, what significant policies\reforms\regulatory mechanisms can be put in place to help ensure greater sustainable growth amongst PSCs in Pakistan?

The following were suggested by the respondents:

- Qualification and experience of directors may be defined.
- Reforms in Federal Public Service Commission especially with respect to engagement of professionals in PSC's.
- Merit based selection of directors to the Board.
- Experienced independent directors should run the company on commercial considerations with clear guidelines on accountability.
- There is ambiguity in Rule 5(2) regarding re-appointment of CEO, which may be made clear.
- Transparent procedure for appointment of honest, diligent and competent team to run PSC.
- Management team with strong and relevant experience.
- Competency, accountability and transparency in management processes.
- Performance based compensation mechanism for management and other employees
- Adoption of best management practices
- PSCs should have independent internal audit function reporting to the Board and external auditors from the top five firms
- No political interference.
- The role of SECP & other related Government agencies may be expedited to implement the Rules in their true spirit
- Technical upgradation
- Policies on public expenditure and management.
- Government administration and civil reforms.
- Legal and judicial reforms.
- Sustainability Plan must be devised with utmost care and maximum possible deliberations

Implementation of the PSC Rules 2013

The Rules were specifically designed to improve the governance of PSCs by strengthening the internal control mechanism, augmenting the disclosure and transparency requirements, and undertaking periodic performance evaluation of the board members.

By and large, PSC's agreed that the Rules facilitated good governance and only a minority of them faced problems in implementing them. Issues arose for these PSC's due to the fact that board members in their respective organizations were not well acquainted with the Rules, and, hence, it was difficult to gain their support when drafting policies in light of the Rules. One respondent stated that they did not have the desired number of independent directors required under the Rules. Some respondents also lamented the absence of a formal merit-based reward system, while adding that clauses regarding HR policies were not sufficient.

State Owned Enterprises (SOE's) in Pakistan fall under various categories in terms of their legal set up, structure and the bodies they report to. However, under the legal and regulatory framework in the country, only those SOEs that have been registered under the Companies Ordinance, 1984 fall under the category of PSCs that are monitored by the SECP. The fact that we received responses from PSCs stating that they were not to be classified as PSC's in itself shows the lack of harmonization or lack of awareness with respect to the definition of PSC's in Pakistan. The same must be harmonized to be able to ensure proper implementation of the Rules and PSC- related policies of the government. Harmonization of legal status would also allow a leveling of the playing field with private competitors. Further, the fragmented ownership of the government in various PSCs, operating in different forms, also needs to be controlled through a centralized mechanism.

It is interesting to note here that even companies that did not wish to be labeled as PSC's (despite falling within the definition of the same) informed us that they had no issue with the provisions of the PSC Rules as such but their concern lay with the increase in the number of other regulatory requirements, that came along with the label, which they felt hampered the agility of their operational functions.

Conclusion

While over 90% of PSC boards comprise of independent and non-executive directors indicating a positive trend of fairly stronger boards, 43.6 % of directors being appointed by the government is a significant figure that does not necessarily display consideration for stakeholder interest. The boards also lack greatly in terms of gender diversity, with only a handful of women directors present on these boards. Good corporate decision-making requires the ability to hear and consider different points of view, which comes from people who have different backgrounds, experiences, and perspectives. Companies that have a transparent nomination and election process look to elect independent directors, taking into consideration the interest of the public at large, as opposed to appointing government representatives that may not necessarily be the most experienced for the role. This sends a clear message that they value diversity of thought and experience and it works towards improving the image of PSC's. An organization's success also largely depends on having the right CEO possessing necessary skills and experience required by the PSC, according to the respective industry it operates in.

However, relatively low fees for their roles as directors and possible political interference may deter competitive individuals from seeking positions on boards of PSCs, as potential candidates may end up choosing the private sector instead. There is a need for policies related to discouraging political interference and formally structuring remuneration. Corporate Governance Training of directors in PSCs should be encouraged to enable better implementation of good corporate governance policies and to ensure long term sustainability of PSC's in line with best practices of corporate governance.

As a first step, perhaps a clear ownership policy needs to be enunciated on the basis recommended in OECD's revised Guidelines on Corporate Governance of State-Owned Enterprises.⁴ Most respondents urged that reforms should be put in place to avert political interference. They stressed that management processes should be made competent, accountable and transparent, while emphasizing the need for merit based selection of directors, and performance based compensation for the management. Respondents were of the view that technological advancements and managements with strong and relevant experience were key factors that could result in the success of PSCs and that sustainability plans for PSCs should be devised with utmost care and maximum possible deliberations. PSCs were also of the view that the role of the SECP and other related government agencies were vital in ensuring the absolute implementation of the Rules.

⁴ (Refer "Rationales for State Ownership, OECD Guidelines on Corporate Governance of State-Owned Enterprises," 2015 Edition)