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PICG
Pakistan Institute of Corporate Governance

INSIDE THIS ISSUE

QUORUM
Catalyst for Change

PICG has a new CEO!

We are pleased to welcome Mr. Ahsan Jamil as the new President and CEO of PICG!

Ahsan draws on over thirty years of diverse professional experience in the multinational corporate sector, private industry and the philanthropic sector in Pakistan. Since 2001 he has played a leadership role in these enterprises. He has established a number of private business and not for profit organisations, and served on numerous boards. In his new role at PICG he looks forward to enhancing the capacity of the wider business sector to meet the critical challenges of governance, innovation and social responsibility.

Upcoming Events

S No.	Date	Training	Duration
1	Jan 4, 2021	Board HR Committee Workshop	Half Day
2	Jan 5, 2021	Board Auid Committee Workshop	Half Day
3	Jan 6, 2021	Board Strategy Committee Workshop	Half Day
4	Jan 7, 2021	Board Risk Committee Workshop	Half Day
5	Jan 13, 14, 15, 20 & 21, 2021	Directors Training Program (DTP)	5 Days
6	Feb 17, 18, 19, 24 & 25, 2021	Directors Training Program (DTP)	5 Days
7	March 8 & 9, 2021	Company Secretary Development Program (CSDP)	2 Days
8	Mar 10, 2021	Effective Minute Taking Workshop	First Half
9	Mar 10, 2021	Board Evaluation Workshop	Second Half
In person physical DTP at PICG: March 2021: 11, 12 & 15, 16, 17*			
10	Mar 18, 2021	Governance in the Public Sector Workshop	Half Day
11	Mar 31, 2021	Directors Training Program (DTP)	Day 1 of 5

* Subject to COVID situation

other 4 days in April

Independent Directors

Why are they not so effective in Pakistan?

by Dr Safdar A Butt

It was only in 1990s that the concept of independent directors attracted the attention of corporate regulators and stock exchanges. After a series of major corporate frauds, a number of corporate governance reforms were introduced. While several corporate governance related reports and codes emerged in UK and Europe, the most serious piece of legislation came in the form of the Surbanes Oxley Act 2002 of USA. By far the most popular development was the placement of independent directors on the boards of listed companies to ensure a balance in corporate direction and representation. According to a recent Harvard Law School paper on corporate governance, 85% of US corporations' directors in 2013 were independent while 60% of the companies claimed to have "super-majority boards" with only one non-independent director. The situation is only slightly different in UK, where in accordance with the Combined Code of CG, the independent directors constitute a numerical majority in virtually all listed companies. There is a tendency in UK companies to classify all of their non-executive directors as independent directors. The revised Code of Corporate Governance issued by Pakistan's SECP in 2017 has recommended that the number of executive directors should not be more than one third of the total board, and that the number of independent directors should not be less than one-third of the total number of board members. All this is fine, but the experience has shown that the presence of independent directors, even if they are in a majority, is not in itself a guarantee of good corporate governance. But first, let us try to understand what is meant by an independent director.

Definition of an Independent Director

Directors in Pakistani listed companies can be divided into three classes: executive directors (EDs), non-executive directors (NEDs) and independent directors, or more appropriately independent non-executive directors (INEDs). According to Sec 166(2) of Companies Act 2017 an Independent Director means a director who is not connected or does not have any other relationship, whether pecuniary or otherwise, with the company, its associated companies, subsidiaries, holding company, or directors; and he can be reasonably perceived as being able to exercise independent business judgment without being subservient to any form of conflict of interest.

Advantages of Independent Non-Executive Directors

Most management scientists and experts on corporate governance believe that effectiveness and efficiency of a board depends largely on the conduct and capacity of its independent non-executive directors (INEDs). These directors are expected to be pure professionals whose presence on the board of directors is intended to improve the quality of decisions made at that forum. Their attendance serves to create a balance of power in the board. The executive directors present their proposals to the board while INEDs evaluate and opine on these presentations. If there are a sufficient number of INEDs on the board, they can over-rule the executive directors on matters that they feel are not in the overall interest of the company. Being professional experts and independent in views, they also serve to promote balance of representation, talent and views on the board. They make the best candidates for membership of various board committees like Audit Committee, HR Committee, Compliance Committee, Risk Management Committee, etc. Having INEDs, who are truly independent, is tantamount to putting a very efficient external auditor or judge on the board of a company. Their presence brings a degree of discipline and diligence to all other directors. As a result, the overall quality of board's decision making process improves significantly. Executive directors and senior managers perform much better and with greater care if the board has a set of competent INEDs.

Why are INEDS not effective?

While a formal research study is yet to confirm the situation in Pakistan, a number of writers on corporate governance, particularly those from developing countries, have opined that INEDs add no real value to listed companies. Arguments put forward by these management scientists explain why the concept of independent directors has lost its sheen, and why INEDs have failed to live up to the expectations of external investors.

a. Many persons who are elected as INEDS do not have sufficient or real knowledge to be able to contribute effectively to the board proceedings. A common, but not so unfounded, assumption is independent directors are carefully selected by the majority shareholders from among their social groups. They simply ensure that candidates meet the legal criteria for appointment as INED but have no capacity or desire to take any real interest in the affairs of the company. Very few companies have formal Nomination Committees to scout for suitable INEDs.

b. Often, good INEDs do not have adequate time for the company. Remember, a lot of companies need good persons, and good persons are generally very busy.

c. Because of low remuneration, INEDs are not willing to devote enough time to the affairs of the company. Again, as their remuneration is based on ttending a meeting, they are not inclined to undertake any task outside the scope of a formal board meeting. They do not meet other stakeholders, nor visit company's facilities, or exchange informal views with senior managers or external consultants. This clearly prevents them from performing their functions as an INED effectively. There is a strong case for paying a salary to INEDs to ensure their participation in activities beyond board meetings. However, a salary should not be used to buy the loyalties of INEDs. A good formula adopted by some European and far Eastern companies is to pay a fixed salary to INEDs that is not less than 50% of the least paid executive director, or more than 50% of the highest paid executive director (except the CEO). No bonuses based on INED's own performance or the company's profits, or other perks like holidays, share options, etc. should be granted to INEDs.

d. Since INEDs are elected on the strength of the votes of controlling shareholders, it is inevitable that the two (i.e. controlling shareholders and INEDs) must have some sort of relationship. Such a relationship can, and usually does, impair the independence of NEDs. Simply put, those INEDs who vote, against their own judgment, in accordance with the wishes of controlling shareholders may be nice people but they are certainly neither effective nor independent. For example, a CEO proposes investment in his pet project which, in the opinion of INED, is not in the larger interest of the company. If the NED votes for the project just to avoid displeasing the CEO, his independence is clearly questionable – and the benefit of having him on the board is lost.

e. Code of CG and Companies Act provide the criteria for INEDS, but the thing that is most important for ensuring the independence of non-executive directors is the willingness of a company (read controlling shareholders) to allow them to be independent. The company should be willing to put up with their independence and pay attention to their views. Independence is a state of mind, it cannot be created by law and regulations.

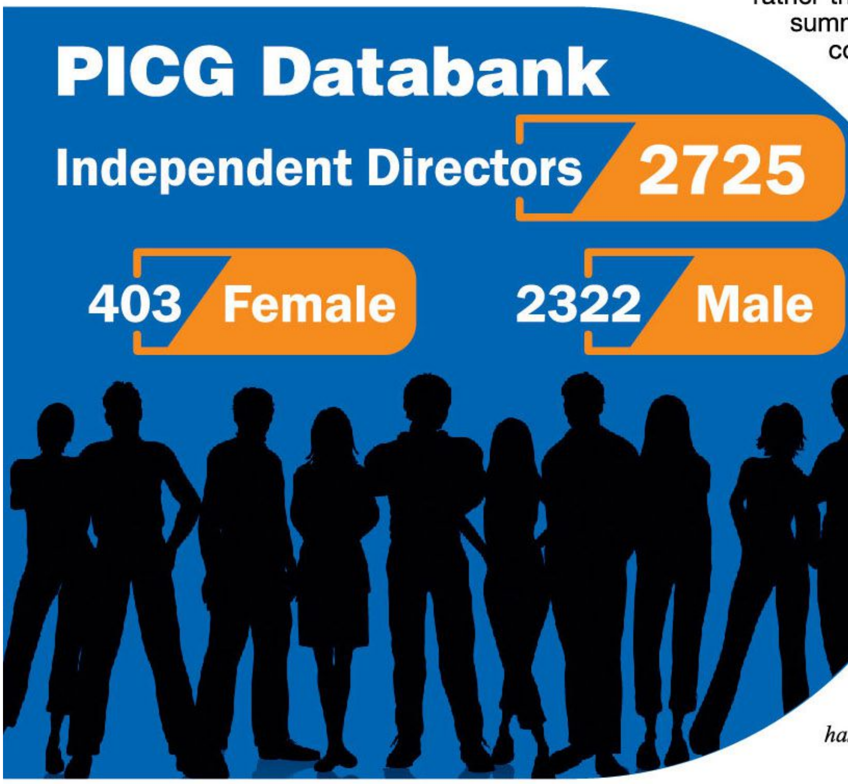
The above criticisms are however essentially about the selection of INEDs and not the concept of having INEDs. They relate to poor or wrong selection of persons for INED positions. If the process of selection is above board, the concept of INEDs can be very useful. In Western countries, a large majority of shareholders of listed companies are outsiders (i.e. not among the executive directors of the companies). For example, at London Stock Exchange, about 72% of shares of all listed companies are held by institutional investors. As a result the institutional investors can and actually do place independent directors on the boards of their investee companies. In Pakistan, most if not all listed companies are controlled by close family or social groups who virtually elect the entire board. Even the provision of collective voting rights in the Law has failed to stop this practice. The inevitable result is emergence of ineffective INEDs who are devoid of any independence.

So what can we do to enhance the effectiveness of INEDs?

We can no longer moan the non-availability of competent independent directors in the country; PICG has done a wonderful job in training directors and maintaining a list of qualified directors from where the companies can get suitable candidates. The tragedy is that controlling families do not look for INEDs from formal channels, but through their personal contacts. What needs to be done is to assure the family controlled companies in Pakistan that truly independent directors can actually add real value to their organizations through improvement in quality of board decisions and enhancement in firm's reputation. PIGC could run a series of programs to make listed companies aware of the benefits of INEDs being truly independent. Formation of Nominations Committees should be encouraged to formalize the selection process of candidates for INED positions.

I tried to conduct an academic research to explore the relationship between the quality of INEDs and financial performance of companies but failed to collect adequate data. There is no true measure in use in our companies to evaluate the effectiveness and/or degree of independence of INEDs. Data arising out of board performance evaluations is not shared by the companies for understandable reasons. The few Board Performance Evaluation reports that I was fortunate to see were deficient in highlighting the degree of effectiveness/ independence of their INEDs. For example, no such report states how many times a director voted against the rest of the board on a particular issue. If the practice of Board Evaluation through an external consultant (every year rather than every three years) is made compulsory, and the summarized results of such evaluations are placed on the companies' websites, sufficient data can emerge in near future to conduct a meaningful research study that may in turn lead to development of proposals for improving INED's effectiveness.

In my 2014 paper on Financial Democracy, I had proposed that the principle of "one share, one vote" should be restricted only to the election of executive directors. The election of NEDs and INEDs should be conducted on the basis of "one shareholder, one vote". This will dilute the monopoly of controlling shareholders on the "selection" of INEDs, allowing the emergence of more effective, independent directors. But I guess we are still quite far from enacting any such changes in Company Law.



Dr Safdar A Butt is a professor emeritus of Corporate Governance & Finance at Capital University of Science & Technology, Islamabad, an author of 37 books, and an independent director at Hi Tech Lubricants Ltd., Lahore. He has previously served on the boards of six listed companies.

Survival Tactics in The Brave New World of Global Partnerships

The Current Business Climate Requires a Review and Reassessment of Your Organisation's Third-Party Relationships

We won't soon forget the year 2020 and the myriad ways worldwide business was derailed over a microscopic virus that caused a global pandemic. From layoffs and shutdowns to shortages and closures, the long-term effects of the pandemic have yet to be determined. But one thing is certain: The disruption to the global supply chain has wreaked havoc in virtually every business sector.

Automobile manufacturing in Korea has been suspended due to a lack of parts from China. The fashion industry in the United States is struggling over sourcing as garment producers in Asia reduce output. U.K. aerospace manufacturer Rolls Royce has announced it is cutting 9,000 jobs as a result of the coronavirus. And sharp declines in consumer demand have adversely affected global manufacturers who in turn are idling production to curb losses.

Global sourcing has been greatly impacted as suppliers have ceased operations, and multinational organisations have had to scramble to locate replacement supply sources.

This gloomy picture has been made all the more daunting as opportunists, bad actors and other sanctioned, restricted or unreputable parties have set up operations to take advantage of unsuspecting and desperate businesses by producing inferior goods, missing contractual deadlines, or operating in ways that could raise flags in the areas of ethical conduct, business integrity or jurisdictional compliance.

As such, multinational companies need to be on high alert for such nefarious outside operations, lest they put their reputations, stakeholders, directors and bottom lines at risk.

Now is the time to identify alternative supply scenarios and re-evaluate contractual terms and performance metrics with those parties in the sourcing network. And to accomplish this, a risk-based approach to diligence, screening and vetting present and potential third-party suppliers is more important now than ever before.

Current Risks

Threats are increasing on several levels for organisations that rely on outside third parties, such as agents, brokers, vendors and suppliers. While depleted inventories, idle production, inferior products and delayed delivery have greatly impacted the marketplace worldwide, multinational businesses are feeling the brunt of these pandemic-induced supply chain disruptions on a greater scale:

- Organisations are suffering financial loss as the supply chain falters;
- Companies are losing customers because of poor-quality products and services from third parties;
- organisations are opening the doors to litigation by working with third parties that may be engaging in bad labor practices or forcing workers to produce in unsafe work conditions;
- Company data systems are being exposed and breached because of poor security practices by third parties.
- Companies are experiencing a greater level of supply chain issues due to poor disaster recovery procedures enacted by third-parties;
- Organisations and boards are increasingly being exposed to litigation because of relationships with outside providers that may have violated contractual terms, potentially resulting in regulatory exposure;
- Such organisations are being targeted by story-hungry media sources determined to expose the company to a global audience.

The result of these increased risks can be highly problematic:

- Business litigation has skyrocketed.
- Corporate reputations are negatively impacted on a larger scale.
- Organisations have had to continually review, reassess and adapt risk management frameworks to adjust and acclimate to an ever-changing global business environment.
- Board members are becoming increasingly subjected to intense scrutiny from outside watchdogs and critics.
- Unfortunately, a highly educated market responds to the above scenarios accordingly with their pocketbooks.

From supply and production disruptions to regional compliance issues and bad media exposure, multinational corporations are facing increased scrutiny working with unscrupulous third-party partners. Thus, the intense need to remain vigilant in conducting due diligence and vetting those outside affiliations.

Why Vet?

In a nutshell, conducting proper due diligence on outside parties safeguards an organisation from a number of risks. As organisations continue to expand their sourcing networks, vetting potential partners in the areas of compliance, integrity, quality, performance and readiness will ensure the company's product line remains in tact while cutting down on the possibility of litigation, fines or penalties. And just as important, vetting will ensure that the company's brand remains vital and untarnished.

Further, proper due diligence on outside partners all but guarantees a degree of business continuity for those organisations that practice proper risk management procedures.

Contd from....By Zafar I. Anjum,

A solid risk-based approach to third-party partnerships will help accurately determine the legal compliance, financial viability, and integrity levels of outside partners, suppliers and vendors who seek to affiliate with, and represent your business.

Such approaches employ programs that use gap analysis and investigative due diligence on targeted third-party partners to uncover and identify any anti-corruption, compliance and risk management deficiencies associated with international regulatory framework. In doing so, those programs can identify and raise a host of red flags, such as:

- Undisclosed third-party transactions.
- Material misrepresentations or ommissions.
- Unreported financial liabilities.
- Criminal or regulatory sanctions.
- Prior bribe or corruption allegations.
- Undisclosed legal or bankruptcy proceedings.
- Politically Exposed Persons (PEPs).

Properly qualified firms that offer third-party risk management solutions and/or certification will employ a network of locally qualified auditors who are highly knowledgeable in the organisation's specific industry, as well as expert investigators, certified fraud examiners and sector-specific professionals who are familiar with the geography, culture and terrain where the investigation is being conducted to add a personalized level of "boots on the ground" due diligence to the investigation.

It's vitally important to retain such risk management experts to provide accurate and reliable counsel while recommending specific strategies and ongoing improvement as an effective preemptive measure.

As the world changes around us, so must the frameworks that guide the proper vetting of outside parties that want to affiliate with and represent your organisation. A properly developed third-party risk management program will protect the organisation against business interruption, brand damage, corporate litigation and director liability.

Zafar I. Anjum, is Group Chief Executive Officer of CRI Group, a global supplier of investigative, forensic accounting, business due diligence and employee background screening services for some of the world's leading business organizations. He has had a 30 year career in the areas of anti-corruption, risk management, fraud prevention, protective integrity, security, and compliance.

By Zafar I. Anjum, MSc, MS, LLM CFE, CIS, MICA, Int. Dip. (Fin. Crime), Int. Dip. (GRC), MBCI, CII Int. Dip. (AML)

source: actionCOACH

Testimonials

We asked our patrons to share their experience with PICG, and the response was overwhelming!

"The workshop was very beneficial. Questions were comprehensively answered by Syed Bulent Sohail. The PICG should continuously arrange such types of workshops for Corporate world."

- ***Muhammad Shahid,*** *Company Secretary at ZIL Limited, on our Workshop on Companies Amendment Ordinance 2020*

"Workshop comprised good coverage of Corporate Governance for Insurance Companies and Mr. Badar facilitated the workshop quite well. The queries from participant were responded to the satisfaction."

- ***Syed Muhammad Taha Naqvi,*** *Financial Controller at IGI General Insurance Limited on our Insurance Governance Workshop*

"The training was thorough and well organized. The material was not only interesting but the discussions were enlightening as well. You have all done a wonderful job at PICG!"

- ***Neha Anseb Azhar,*** *Legal Manager at GlaxoSmithkline Pakistan Limited on our Company Secretary Development Program*

CEO's Letter

Taking the reins of the Pakistan Institute of Corporate Governance on July 16, 2020, while still coming off the peak of the COVID-19 pandemic and ensuing lockdown, my first priority was to ensure the health, safety and morale of my team. And so, apart from two brief physical orientations at the office, I began my tenure virtually, with regular check-ins through virtual meetings.

The second was ensuring business continuity; and in that regard it was key to ensure our flagship Directors Training Program stayed on course. The team had already taken this online under the able and timely guidance of our acting CEO Arjumand Ahmed, with the first ever virtual DTP successfully conducted in April, 2020. We have since then built upon this and focused all our efforts on logistics and programming and successfully transitioned our entire program portfolio including specialized workshops to a virtual platform. Our faculty must be lauded for having so confidently adapted to the virtual training environment as well as our experienced team that managed this transition and supported them so ably.

So since July while I have been trying to settle in with the support of a very empowering board, we have also been actively reflecting on the dramatic changes we are in the midst of, exploring new ideas and embracing longer term thinking with a sense of urgency; widening the definition of Governance to include social impact and gearing up to advance significant new initiatives around Environment, Society and Governance (ESG, see new annual report on our website and interviews with some important global thought leaders). An interesting trend to note is: a historic transfer of wealth to the tune of $24 trillion are shifting from baby boomers to increasingly millennial decision makers globally over the next two decades, according to a Deloitte survey. There is a rapidly growing attraction of global capital to sustainability and ESG practice and millennials are increasingly prioritizing societal needs being met over just increasing the bottom line. ESG is a fast-growing and important trend that only some of our business leaders in Pakistan recognize, while many pay lip-service or ignore this, all at our collective peril. Yet it is an exciting time for the Institute because we can see PICG's mission broadening to include so many facets of good governance: ensuring effective, inclusive and responsive governance; crisis management in health and safety including mental health; policy advocacy to build back public trust; the role of youth in governance and leadership; and consultations over regulatory policy that factors in environmental and social responsibility as well as gender diversity and inclusion.

We are enhancing the design and content of our entire program portfolio that offers lifelong learning and development. We are expanding the Institute's reach to small and medium enterprises, particularly women-led SMEs, that form the backbone of Pakistan's economy, as well as to not for profit organizations doing important safety-net work.

Meanwhile the Institute's membership is growing as testament to our member outreach and the benefits of being part of a premiere national governance institute network. The Institute's Annual Report 2020 (Link:picg.org.pk) themed 'Governance with Social Impact' is a call for more engaged and socially aware governance; and I hope it will resonate with all our members and beyond and help trigger board-level discussion. The Institute's next 3-year strategy is to expand this governance agenda through creating strategic partnerships and network linkages with the private sector, development institutions and international donors, and most importantly academia to help drive this agenda. In this important work, I look forward to our members' engagement, feedback and support.

Sincerely,

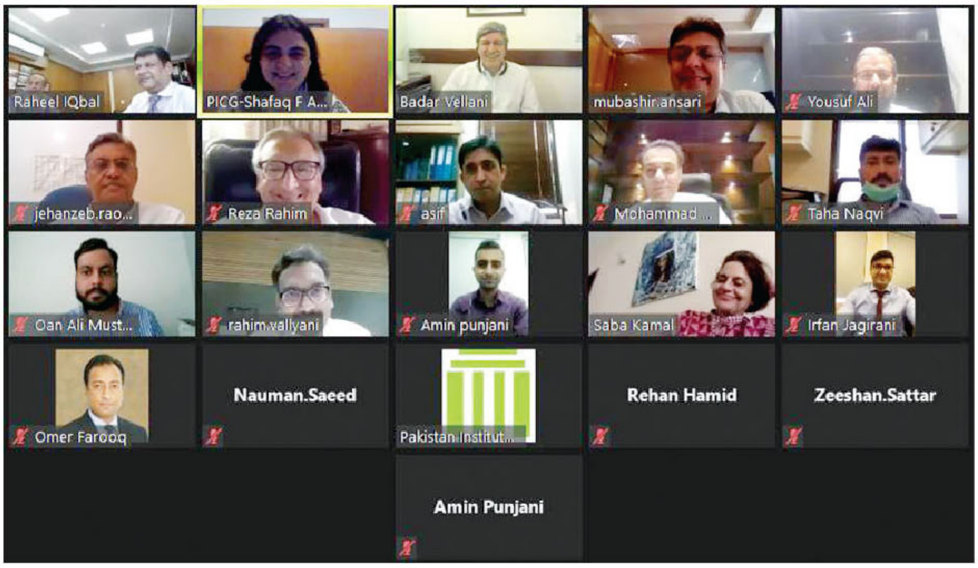
Ahsan Jamil

Quarterly Training Update

Director Training Program: **3**

9 In other Workshop:

1480 Total Certified Directors to date:



Feedback & Suggestions

You have looked through this issue of 'QUORUM'. We await your feedback and suggestions as to how to make it more useful, relevant and interesting. Write to us at: suroor@picg.org.pk

Contact Us

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