SPEECH

Opening Remarks

Assalaamu alaikum and good morning, ladies and gentlemen.

It is an honor to address you today at PICG's first ever Directors Summit on a topic of paramount importance for our nation's economic future: ie. '**Corporate Governance'.** In Pakistan, the significance of robust corporate governance cannot be overstated, being crucial for **fostering trust and attracting investment**, which is essential for economic prosperity.

I am delighted to see the participation of **several stakeholders in today's summit** which promises to be an enriching experience, packed with valuable insights and practical tips for driving progress.

Brief overview of CG development in Pakistan over the years: (3mins)

In order to discuss advancement and growth, we must **acknowledge past successes and challenges while remaining mindful of the current, ever-evolving economic and political landscape our country faces today.**

As we all know, the Corporate Governance Code first introduced in 2002 by the Securities and Exchange Commission of Pakistan, was driven by the **need to improve transparency, accountability, and investor confidence** in the wake of global corporate scandals. Over the years, the Code evolved with several revisions to **align with international best practices** and **address emerging governance challenges** bringing in more specific requirements pertaining to board structure and independence and streamlining board duties, effectiveness and reporting. Separate Codes were also issued for the public sector, as well as for the banking and insurance industry focusing on enhancing their specific governance standards and operational efficiency whilst ensuring financial stability and sound risk management practices. And while the primary focus over the years had been on listed companies, a set of corporate governance principles was also introduced for non-listed companies to encourage voluntary compliance and enhance overall governance standards. These codes, collectively, aimed to foster a culture of good governance across various sectors.

In recent times initiatives such as: Guidelines on Code of Conduct for Public Listed and Public Sector Companies; Stewardship Guidelines for Institutional Investors; enhancing voter facilitation; ESG Disclosure Guidelines and Anti-Harassment Policies; and enhancement of board responsibilities on sustainability and DE&I, have been introduced to further strengthen corporate governance regime in Pakistan.

Moreover, PICG has, for the past 20 years, been working to create and promote awareness and adoption of corporate best practices through policy advocacy, capacity building, advisory services and providing a platform to exchange opinions, knowledge, and information.

Significance of CG in Pakistan's prosperity (7mins)

So let me now draw your attention to the significance of Corporate Governance in Pakistan's economic growth.

1. Capital Market growth and the access to international market finance

We are all aware that Pakistan now, more than ever, needs access to international finance. Capital markets growth is therefore necessary to attract local and foreign investment; and its growth is dependent on diverse offerings, agile and well governed systems and equitable and transparent participation opportunities to all players.

International Finance investors agencies and donors place very high importance to corporate governance. For eg. the World Bank and the International Finance Corporation (IFC) consider several key aspects of sound corporate governance in their investing decisions such as: Commitment to Environmental, Social, and Governance (ESG) Principles, Disclosure and Transparency, Board Structure and Functioning, Treatment of Minority Shareholders, Control Environment, and Governance of Stakeholder Engagement. **These criteria help ensure that the entities they invest in are well-managed, transparent, and committed to sustainable and ethical practices.**

A notable example is that of **Malaysia**, who have **significantly enhanced their international market access** through improving their corporate governance systems by regularly aligning with international best practices, emphasizing transparency, accountability, and sustainability and implementing stringent regulations to ensure compliance with corporate governance standards.

However, **to ensure holistic capital market development, governance standards must be cross-sector** and not only focused on listed companies. Therefore, it is important to emphasize **Enhanced Corporate Governance support for SMEs and Start-ups:**

2. SMEs

With SMEs representing about 90% of all businesses in Pakistan, accounting for approximately 80% of non-agricultural employment and contributing nearly 40% to the country's GDP annually. Therefore, strengthening the infrastructure of the capital market through SME sector development will support access to finance for industries and businesses at large and promote "Brand Pakistan", opening the doors to further international market access.

According to a Mc Kinsey report:

i. **Singapore:** has established a comprehensive support framework for SMEs, including grants, **tax incentives, and access to technology and innovation resources**, and the government also facilitates international expansion through various trade agreements & support programs.

ii. The **Business Development Bank of Canada** (BDC) also plays a key role in providing **financial and advisory support to SMEs**

iii. Likewise, the **US, Germany and UK governments** offers financial incentives, research and development grants**, advisory services and export assistance to help SMEs compete globally.**

In Pakistan, the **Companies (Further Issue of Shares) Regulations, 2020, were introduced by SECP to facilitate SMEs and startups in raising equity**, and a **National SME Policy 2021** was approved by the government to address various challenges faced by SMEs, but there is a **need for focused capacity building and hand holding to enhance governance structures and performance for this significant "unstructured sector"**.

3. SOEs

State-Owned Enterprises (SOEs) in Pakistan contribute approximately 10% to the country's GDP. They also employ around 0.5 million people and account for about 28% of market capitalization. However, several loss-making SOEs significantly add to the financial burden on the economy.

As example of SOE turnaround, is China's centrally administered state-owned enterprises **three-year action plan** for SOE reforms initiated in 2020, featuring ownership overhauls and market-oriented operations, which resulted in their **best performance ever** in 2021, despite Covid with record-setting revenues and profits, that went up 29.8 % to hit 1.8 trillion yuan.

Likewise, the **new State-Owned Enterprises (SOE) Act and SOE Policy** introduced by the Government of Pakistan aspires to enhance the **governance, management, and operational efficiency of state-owned enterprises** with regular monitoring and evaluation of SOE performance to ensure they meet their objectives and contribute to national development. Strengthening **governance structure and accountability is expected to promote fiscal discipline, reduce financial risks and align** SOEs with the strategic objectives of the government. The new regulations also **mandate regular and transparent reporting of SOE activities, financial performance, and governance practices to stakeholders**.

These measures should result in making SOEs more competitive, efficient, and accountable, ultimately contributing to the overall economic growth and development of the country.

4. Adopting sustainable governance practices for financial growth

Indeed, Pakistan faces significant environmental and social challenges, which are increasingly being recognized as business challenges and hence, the focus of governance around Environment & Social issues. Companies are now expected to adopt sustainable practices to mitigate their environmental impact on Climate Change, pollution, resource management and also manage social issues such as gender equality, labor rights and community engagement.

In September 2023, the **OECD Principles of Corporate Governance were revised and endorsed by G20 leaders.** The key changes made included the **emphasis on the need to enhance reporting on sustainability-related information, board responsibilities regarding sustainability matters,** and **improve dialogue between companies and their shareholders and stakeholders on sustainability issues** to ensure that companies are responsive to the expectations and concerns of their stakeholders.

Aligned with the international emphasis, the SECP released ESG disclosure guidelines and recently amended the Code of Corporate Governance to include board oversight over sustainability matters and Diversity Equity and Inclusion (DEI) as a **part of the board's overall duties**. The amendment recommends the establishment of a dedicated Board ESG Committee, or at least assigning sustainability responsibilities to a specific Board committee.

Likewise, the State Bank of Pakistan has issued the Environmental and Social Risk Management (ESRM) framework to **integrate environmental and social risk considerations into the core business processes of financial institutions**; and the Pakistan Stock Exchange (PSX) recently released the PSX Primer on Environmental, Social & Governance (ESG) designed to **guide listed companies on how to report on ESG factors effectively**.

Financial institutions are also expected to provide more green financing opportunities to attract responsible investment. **U.S. private and public financial actors** provided an annual average of **$74 billion in climate finance** which is more than a three-fold increase since 2014, accounting for just under 13% of the global annual climate finance flows (of approx. $574 billion). It is also interesting to note that **90% of U.S.-originated climate finance comes from private sources**.

Similarly, echoing the central government's **"30/60" decarbonization goal of reaching a carbon peak before 2030 and carbon neutrality before 2060, China attaches great importance to the role of finance in green and low-carbon transition**, putting in place a multi-tiered green finance market system. Benefiting from "top" government policies and "bottom" local initiatives like the carbon trading market and green finance pilot zones, China has seen rapid development of green industries over the past decade. China's green loans logged an increase of about 520.66 billion U.S. dollars in the first quarter of 2024 (Q1) hitting an all-time high.

The financial institution, regulators and PSX must work together to fast-track green market development in Pakistan and boards and management must be made aware of the opportunities available in this regard.

5. Improving efficiency through Technology enhancement

Pakistan is experiencing rapid technological adoption, via a Growing Tech Ecosystem, Increased Mobile Connectivity, Government Initiatives supporting the tech sector, and a growing Freelance Market. This next-generation technology is expected to further accelerate digital transformation creating a vibrant tech landscape in Pakistan, opening new opportunities for economic growth and innovation.

Corporate Boards must ensure they are abreast with technological advancements, to direct investment in IT infrastructure that is essential for sustainable growth, resilience, and prosperity at both the corporate and national level. Likewise, they must be made aware of their duties related to oversight of cyber risks and disruptions associated with such technological enhancement.

In the World Economic Forum's latest Global Competitiveness Report, Germany was awarded the title of the "**world's most innovative economy"** - being one of the 12 drivers of a country's productivity. This was achieved through the new **High-Tech Strategy** they adopted, with a goal to ensure **"good ideas are translated quickly into innovative products and services"**.

Hence, it is important for Pakistani companies, boards and management not to lose out on opportunities and be able to manage associated risks to bring effectiveness and efficiency through the adoption of tech solutions.

Issues & challenges. (5mins)

While the benefits are clear, implementing effective corporate governance in Pakistan comes with its own set of challenges. These include **lack of awareness, regulatory burdens and resistance to change**. However, these challenges also present opportunities for improvement and innovation.

1. General Awareness & Understanding of Corporate Governance Benefits

Insights from a recent study by PICG revealed a gap between the perceived importance and the actual implementation of corporate governance practices within the SME sector in Pakistan. Results showed that only 6% consider governance pillars appropriately embedded in current business operations. This highlight (i) a lack of confidence in the value that these practices bring and (ii) value for money/return on investment considerations to adopt these practices.

Companies should invest in educating their boards and management teams about the real benefits of good governance and how to implement it effectively. By understanding and applying the true essence of corporate governance, companies can unlock significant financial and operational benefits, contributing to their long-term success and sustainability.

The same study revealed that when considering the possibility of future implementation, interestingly, over half of respondents (54%) foresaw considerable challenges in putting these principles into action.

2. Regulatory Burdens:

Complex and sometimes burdensome regulatory requirements can deter companies from fully embracing corporate governance practices, Therefore, streamlining regulations and providing clear, concise guidelines can make compliance easier. Regulatory bodies can also offer support and resources to help companies navigate these requirements.

In a recent survey conducted by PICG on Corporate Governance Trends in Pakistan, it was noted that the number 1 area of focus for companies in Pakistan remains legal and regulatory compliance with 64% of respondents prioritizing it this year.

While compliances must be achieved, it is upon those charged with governance to ensure that strong and structured systems are in place so that boards may spend their time concentrating on global longer term strategic matters.

3. Capital Market and ownership structures

In Pakistan, the ratio of private to public companies is significantly skewed towards private companies that dominate the business landscape and most listed companies have limited public offering. Companies with concentrated ownership often face challenges related to control and decision-making.

Appointing independent directors can help balance the influence of major shareholders and ensure more objective decision-making and establishing clear policies and procedures can help mitigate conflicts of interest and ensure transparency.

4. Local political instability and macro-economic challenges

Undoubtedly, Pakistan is constantly dealing with unprecedented political and economic challenges that have hindered growth of businesses. Boards must therefore ensure strategies are **flexible and ready to adapt** to changing conditions. This might involve diversifying products, services, or markets to reduce dependency on any single factor and **robust risk management strategies must be ensured to help anticipate and mitigate potential disruptions.**

For example, in Japan, companies are known for their long-term strategy focus but have recently adopted more flexible governance structures to remain competitive in the fast-changing global market. This includes increased use of Independent Directors; and opting for smaller boards which can be more agile and effective in decision-making.

Further, it is also **important for those charged with governance to build strong networks** with local stakeholders, including government officials, community leaders, and other businesses that can provide support and insights during turbulent times, which can be crucial during times of instability.

Way forward (5mins)

1. Diversity in Board structure and composition.

Skill diversity on boards is crucial, especially in today's rapidly changing economic environment. A board with diverse skills can quickly adapt to new economic trends, technological advancements, and market shifts, ensuring the company remains competitive. Diverse perspectives foster innovation, helping companies develop creative solutions to emerging challenges.

Similarly, bringing in younger board members can drive innovation. Germany's corporate governance framework has increasingly focused on bringing younger, tech-savvy professionals into the boardroom, fostering innovation and modernization in corporate leadership.

Further, promoting gender diversity at all organizational levels, especially in strategic positions, is crucial. As of recent data, there is only about 11% female representation listed company boards in Pakistan. This indicates that while there has been some progress, there is still a significant gap in gender representation in corporate leadership in Pakistan.

Improving the diversity ratio on boards requires a multifaceted approach such as

- Setting Clear Goals and Commitments
- Revise Recruitment Practices
- Expand the Talent Pool
- Mentorship
- Regulatory and Policy Support

By implementing these strategies, companies can make significant strides towards achieving diversity on their boards, leading to better governance and overall business performance.

2. Enhance market communication via more transparent & timely information sharing

Enhancing communication with stakeholders is a vital aspect of improving corporate governance. Several modes may be used, however, a regular dialogue goes a long way in ensuring goals are aligned and everyone is moving in the same direction, whilst enhancing transparency and building trust.

Further, involving minority shareholders in key decisions, for example through voting and feedback mechanisms, can enhance their sense of ownership and alignment with the company's goals and interests.

The Minority Shareholder Watch-dog Group of Malaysia works to create awareness among minority shareholders of their three basic rights, **i.e., to seek information, voice opinion and seek redress,** and various avenues are available to shareholders that encourage shareholder activism.

In Pakistan, PICG is currently working with CDC to develop a portal for shareholders knowledge and awareness, which will also provide several online facilities.

3. Impact assessments

The absence of impact assessments can indeed reduce CG to a mere "tick the box" exercise. There is, therefore, a dire need for the Regulator to determine **mechanisms to measure the**

effectiveness of governance practices, ensuring they are not just formalities but are genuinely contributing to the company's success.

- The **UK & German Regulators conduct regular impact assessments** to evaluate the effectiveness of their respective Corporate Governance Codes to refine governance practices and ensure they meet the evolving needs of the market.
- Likewise, the **Securities Commission of Malaysia** conducts impact assessments to ensure that the governance practices are effectively contributing to market integrity and investor confidence.
- **South Africa's King IV Report on Corporate Governance** includes provisions for regular impact assessments to help understand the effectiveness of governance practices and their contribution to sustainable economic development

4. Regulatory Support and Enforcement of regulation: legal measures

As they say: "if you think compliance is expensive, try non-compliance." Hence, Boards must always ensure strong systems are in place to ensure this.

On the other hand, the effective enforcement of corporate regulations must also be ensured to protect investors' rights and contribute to the stability and integrity of financial markets.

Addressing these challenges through legal reforms, capacity building, and improved judicial processes can significantly enhance the enforcement of corporate regulations in Pakistan, leading to a more robust and transparent business environment.

In conclusion, corporate governance is not just a regulatory requirement; it is a key lever for Pakistan's prosperity. By fostering a culture of transparency, accountability, and responsibility, we can build stronger companies and a stronger economy.

Let us all commit to upholding the highest standards of corporate governance and work together towards a brighter future for Pakistan.

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