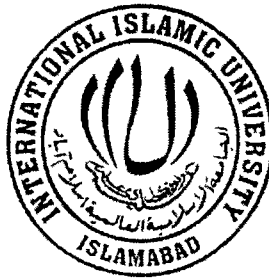


STATE OWNED ENTERPRISES (SOEs) IN PAKISTAN: CORPORATE GOVERNANCE ISSUES AND PROSPECTS



A dissertation submitted in partial fulfillment of the requirement for the degree of Masters of
Law (L.L.M)

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FINAL APPROVAL

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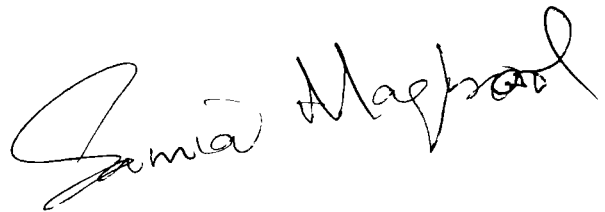
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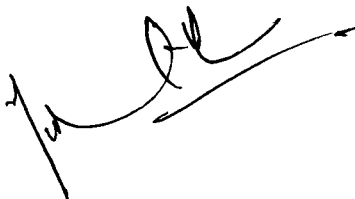
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ABSTRACT

Corporate governance plays a vital role in shaping business enterprises' performance, accountability, and transparency, and its significance becomes even more pronounced when considering State-Owned Enterprises (SOEs). This thesis thoroughly examines the legal framework and theoretical underpinnings of corporate governance in the context of SOEs in Pakistan. The introductory chapter establishes the groundwork for the research by presenting an overview of the study's objectives, the context of corporate governance in SOEs, and the rationale for its importance. A concise literature review underscores the existing knowledge gaps and research questions are formulated to guide the investigation. The legal Framework of Pakistan's Corporate Governance Related to SOEs is discussed in Chapter 2, which traces the evolution of corporate laws in Pakistan, illuminating the legislative journey that has shaped the corporate governance landscape. This chapter further highlights the role of governance mechanisms in ensuring accountability, efficiency, and transparency in these entities. Chapter 3 discusses theoretical perspectives and legal frameworks on corporate governance and compares OECD principles with Pakistani laws. The agency, stakeholder, stewardship, and institutional theories are explained and correlated with the domestic laws of Pakistan. Chapter 4 is about the legitimacy of government shareholding in SOEs by scrutinizing legal foundations, economic justifications, accountability mechanisms, transparency measures, and the broader implications for public interest and social responsibility. Chapter 5 is regarding the Implementation and Enforcement mechanism of corporate governance laws and principles related to SOEs in Pakistan. A theoretical framework is constructed to evaluate the effectiveness of enforcement mechanisms, including examining corporate judicature in Pakistan and existing judicial challenges. The final Chapter 6 concludes with research findings and well-considered recommendations for enhancing corporate governance, ultimately contributing to a more accountable and transparent SOE landscape in Pakistan. This thesis offers a multifaceted

exploration of corporate governance within State-Owned Enterprises in Pakistan, drawing on legal, theoretical, and practical dimensions. This research contributes to the ongoing discourse on effective governance and accountability in state-owned enterprises by bridging the gap between legal frameworks, theoretical underpinnings, and practical implementation.

DECLARATION

I, Mr. Shamraiz Abbas Khan, bearing Registration No. 651-FSL/LLMCL/F19, do hereby declare that this dissertation title: "State Owned Enterprises (SOEs) In Pakistan: Corporate Governance Issues And Prospects" submitted before the Department of Law, Faculty of Shariah and Law, is original work of mine, to the best of my knowledge and belief and has never been presented in any other university or institute of learning. I also declare that this dissertation has never been copied and any secondary information used therein has been duly acknowledged in this dissertation.

Supervisor: Hafiz Muhamamd Usman, Department of Law

Student: Mr. Shamraiz Abbas Khan

Signature: _____

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LIST OF ABBREVIATIONS

AOA:	Articles of Association
ADB:	Asian Development Bank
AGM:	Annual General Meeting
AOA:	Articles of Association
BESOS:	Benazir Employees Stock Option Scheme
BOD:	Board of Directors
CA:	Companies Act 2017
CCG:	Code of Corporate Governance
CEO:	Chief Executive Officer
CFO:	Chief Financial Officer
CG:	Corporate Governance
CLD:	Corporate Law Decisions
DFI:	Development Financial Institutions
FDI:	Foreign Direct Investment
IASB:	International Accounting Standards Board
IAS:	International Accounting Standards
ICAP:	Institute of Chartered Accountants of Pakistan
IFRS:	International Financial Reporting Standards

IMF: International Monetary Fund

IOSCO: International Organization of Securities Commission

KSE: Karachi Stock Exchange

MOA: Memorandum of Association

NBP: National Bank of Pakistan

NEDs: Non-executive Directors

OECD: Organization for Economic Co-operation and Development

PICG: Pakistan Institute of Corporate Governance

SBP: State Bank of Pakistan

SC: Supreme Court

SCMR: Supreme Court Monthly Review

SECP: Securities and Exchange Commission of Pakistan

The CCG: the Code of Corporate Governance

The Constitution: the Constitution of the Islamic Republic of Pakistan,

The Ordinance: the Companies Ordinance, 1984

SECP: Securities and Exchange Commission of Pakistan

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CHAPTER 1: INTRODUCTION

1.1. Introduction

State Owned Enterprises (SOEs)¹ are business enterprises that are managed and controlled by the governments. Government control is a common feature among these State Owned Enterprises (SOEs). In many OECD countries, numerous SOEs are operating in a wide range of markets sectors like energy, transportation, services, engineering, finance. Pakistan has around 212 SOEs² including PIA, WAPDA, NBP, NICL, Pakistan Railway (PR), and so on. These SOEs can play important role in the growth of the country's economy as it is contributing about 12% of GDP in Pakistan.³

State Owned Enterprises (SOEs)'s failures due to poor governance are a major problem in the corporate sector of Pakistan and hurting the country's economy. In other developing countries like India and Sri Lanka, much has been said and much has been done about the corporate governance issues related to SOEs. But in Pakistan, SOEs are making financial losses and adding to the national debt and the main factor behind SOEs' failures and financial losses is noncompliance of principles of corporate governance incorporated in the Code of Corporate Governance 2019 issued by the Security Exchange Commission of Pakistan (SECP).

One of the main factors behind this noncompliance is the government's ignorance towards this issue. Though many attempts have been made by the legislature/government to improve CG issues in SOEs and

¹ "Companies act, 2017", Section 2 (54), Last accessed on March 16, 2021, can be accessed at https://na.gov.pk/uploads/documents/1487136261_767.pdf,

² Finance Division, "State-Owned Enterprises Triage: Reforms and Way Forward." Government of Pakistan, March 03, 2021, Page No.6, Last Accessed on March 17, 2021, can be accessed at https://www.finance.gov.pk/publications/SOEs_Triage_03032021.pdf

³ Information is collected from Page no.19 of World Bank Report can be accessed at <https://openknowledge.worldbank.org/bitstream/handle/10986/35595/975154310013.pdf;jsessionid=227426/state-owned-enterprises-reports-top-education-on-the-ec> ; The Dawn News, 'an article published on loss making state owned enterprises on July 01, 2021, can be accessed at <https://www.dawn.com/news/1632423> ; Daily times, 'an article published on state owned enterprises in Pakistan - a drain on the economy by Dr. Karm Khan on November 29, 2018, can be accessed at <https://dailymirror.com.pk/2018/11/29/state-owned-enterprises-a-drain-on-the-economy/>

to overcome the financial losses of SOEs, still there is room for more developments and improvements.

This thesis will assess the effectiveness of the Corporate Governance framework of Pakistan by considering CG laws related to SOEs i-e Code of Corporate Governance 2019 (CCG). It will also throw light on the role of regulators i-e SECP, SBP, and PSX to update CCG on regular basis to cope with modern developments and changes. The regulatory framework related to SOEs mainly consists of the institutional framework and legislative framework. The institutional framework consists of two main regulators i-e firstly SECP being a regulatory body and secondly Federal Government of Pakistan through its ministries having majority shareholding in SOEs. This thesis will also try to investigate the role of both institutional and legislative framework. It will focus on the enforcement mechanism of SECP to assess and evaluate the performance and compliance behavior of SOEs to promote transparency. There is no specific Legislative framework specifically for SOEs in Pakistan, except Corporate Governance Rules 2013 notified by SECP. Moreover, the significance of regulations related to internal governance and competent Board of Directors is also considered in this thesis. Companies Act 2017 suggests effective BOD consisting of at least two independent Non-Executive Directors and Executive Directors for the management of companies and provides a mechanism regarding their appointment and removal, which is also discussed in this study. This study will also examine the regulations related to the internal control system and disclosure practices (financial reporting) of SOEs which can ultimately build the confidence of potential users i-e investors and shareholders and can play a pivotal role in Business valuation.

SOEs in Pakistan due to their privileged position in the market are also exploiting the competition and leaving an adverse impact in the free market by creating its own monopoly in the corporate sector. Because these SOEs are also subject to similar competition as private companies are facing, so this study will also study the law related to competition in Pakistan i-e, Competition Act 2010, and also discuss the anti-trust issues in

the corporate sector due to the privileged position of SOEs in the free market.

So the purpose of this study is to investigate the corporate governance laws related to SOEs which mainly include Companies Act 2017, Securities Act 2015, and Stock exchange listing Rules, Code of Corporate Governance 2019 and Corporate Governance Rules 2013. It will also discuss the importance of the Memorandum of Associations (MOA) and Articles of Associations (AOA) being a constitution of SOEs in Pakistan. This thesis will also discuss OECD principles of CG, theories of Corporate Governance, and the effectiveness of the compliance and enforcement mechanism of regulators to successfully implement these laws in true letter and spirit for SOEs fair valuation and better performance.

Thesis Statement:

Corporate scandals and failures of State Owned Enterprises in Pakistan due to poor corporate governance are making financial losses and creating a burden on the National Exchequer; hence an appraisal is required to examine the effectiveness of the CG framework and laws by identifying their weaknesses and explore the opportunities for improvements and reforms.

1.2. Literature Review:

Government appoints BODs in PIA, NBP, OGDCL, and PSO as per her will based on nepotism, without following the procedure mentioned in the Companies Act 2017 and ignoring the procedure of succession. Faryal Salman and Kamran Siddiqui in their article "Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan" have discussed such absence of proper succession procedure in these SOEs which is the violation of Corporate Governance laws due to ignorance and malafide on the part of the Government.⁴

⁴ Salman, Faryal, and Kamran Siddiqui, "Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan." The IUP Journal of

Mangi, Riaz Ahmed, and Kamran Ahmed Siddiqui in their article "Privatization of PTCL: Corporate Governance Failure" discussed the privatization of PTCL which is also another example of corporate failure in Pakistan due to lack of good corporate governance, fraud, and hasty decision-making of privatization. It was the government's duty to determine the feasibility of privatization through financial analysts and auditors. During the process of privatization, the successful bidder was given an undue concession to make this bid successful which ultimately resulted in financial loss of multi-billion rupees to the national exchequer. This acquisition of PTCL and undue concession in the bid was not only against the constitution of the company i.e MOA but it also got exempted from the purview of the Procurement Regulatory Authority Ordinance 2002.⁵

National Insurance Company Limited (NICL) scandal of around Rs3.5 billion is another example of the failure of enforcement mechanisms. Where the culprit was charged guilty by investigation agencies NAB and FIA but no action whatsoever was taken after this. This set another example of the failure of enforcement mechanisms and the failure of corporate regulators.⁶

Rukhsar Ahmed and Imam ud Din in their research article "Failure of Corporate Governance in Pakistan" gave the example of Pakistan Railways' (PR) that was once considered to be the cheapest and safest mode of transport. But the failure⁷ and privatization of eight railway lines⁸ is another

Corporate Governance 12, No. 4 (2013) : 13-23, Last accessed on April 5, 2021, can be accessed at

https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID2967752_code2253827.pdf?abstractid=2445955&mirid=1

⁵ Mangi, Riaz Ahmed, and Kamran Ahmed Siddiqui, "Privatization of PTCL: Corporate Governance Failure." CGN: Other Corporate Governance: Acquisitions (2013), Last accessed on April 6, 2021, can be accessed at Research Gate at https://www.researchgate.net/profile/Riaz-Mangi/publication/316240211_Privatization_of_PTCL_Corporate_Governance_Failure_files/5c20b056a6ddec704652554/Privatization-of-PTCL-Corporate-Governance-Failure.pdf.

⁶ "NICL scandal", Dawn July 3, 2003, Last accessed on April 10, 2021, can be accessed at Dawn website at <https://www.dawn.com/news/601723/nicl-scandal>

⁷ Dr. Rukhsar Ahmed, and Imam ud Din, "Failure of Corporate Governance in Pakistan Railway." International Journal of Sciences and Engineering 4, no. 5 (2015): 8-12. Last accessed on April 22, 2021, can be accessed at http://www.ijmse.org/Vol.no4/Issue4/ijmse_1216.pdf.

example of SOEs failure due to corruption, mismanagement, induction of inexpert, ineligible staff, and bogus employees on the payroll, weak internal controls, and weak CG structure. In the past, NAB also declared it a scandal of Rs 480 billion. Moreover, PR is also suffering huge losses in lieu of lease and rental charges from private companies and other SOEs. This failure is also due to a weak internal framework, and the absence of a CG mechanism.⁹

In a case law *Muhammad Imran vs Muhammad Sajjan Panhwar*, the Learned High Court ordered the removal of the petitioner/CEO of Generation Holding Company Limited (GHCL) on the ground that he was not qualified for his appointment as he was holding the post of a professional engineer while being a chartered accountant. August Supreme Court of Pakistan suspended the operation of the judgment of the Learned High Court on the ground that neither in the Public Sector Companies Corporate Governance Rules 2013 nor in the Public Sector Companies (Appointment of Chief Executive) Guidelines 2015, there was any provision for the CEO to hold a specific degree of expertise in his relevant field.¹⁰ This shows the ineffectiveness of CG rules and guidelines due to which unqualified executives will be inducted into the top corporate structure of SOEs which will ultimately have an adverse impact on the governance culture of the company and will give rise to conflict in the management.

In a case law *State Life Insurance Corporation of Pakistan vs Commissioner Insurance, SECP*, the policyholder of the insurance policy suffered a monetary loss due to misleading and deceptive conduct of the insurance company. SECP commission ordered the corporation to settle the grievances of the policyholder and warned to be careful in the future of any such misleading and deceptive conduct towards the policyholders. In an appeal in appellant bench, Corporation/appellant contended that SECP had

⁸ Daily Times, 'KCR, Shah Latif express are given to the private sector by Pakistan Railways' on January 11, 2022, Last accessed on April 23, 2022 can be accessed at <https://dailytimes.com.pk/367133/kcr-shah-latif-express-given-to-private-sector-by-pakistan-railways>

⁹ Ibid note (5)

¹⁰ *Muhammad Imran vs. Muhammad Sajjan Panhwar* 2021 SCMR 1883 Supreme Court

no jurisdiction to entertain such disputes which required recording of evidence the powers of which are vested in the civil court. Learned appellant bench declared this act of corporation as a classic example of breach of trust. Also declared that SECP was competent to entertain such complaints of policyholders by virtue of S.20 (6) (fa) & (g) of SECP Act 1997 and S.76 (4) (5) and S.156 of Insurance Ordinance 2000 under which Commission can monitor the conduct of insurers towards the insurance policy holders. Learned Appellant bench imposed a fine of Rs One Million on the Corporation due to failure of maintaining adequate internal controls and systems as required by Insurance Ordinance 2000.¹¹ This shows that a strong internal controls system is significant for the transparent and good governance of the SOEs.

In case law, Habib Bank Limited vs Honorable Justice Imran Inayat Butt, The company failed to follow the requirements of Regulation 16 of the Listing Regulations of Karachi Stock Exchange under which it had to communicate to the Exchange all decisions of BOD regarding cash dividends, bonus issue, right issue, or any other entitlement, corporate action, and other sensitive price information on time to time basis in the manner prescribed by the Exchange. SECP considered it as a serious matter and violation of Regulation 16 of Listing Regulations KSE which subsequently was a violation of S.22 of Securities and Exchange Ordinance, 1969. Due to the good reputation of the company, Commission took a lenient view and didn't take penal action but issued a stern warning to the company to ensure full compliance with related rules and regulations in the future for avoiding any punitive or penal action under the law.¹²

Ministry of Finance published a report "State Owned State-Owned Enterprises Triage: Reforms and Way Forward" which is an outcome of substantial consultation and cooperation involving the Finance Division, the International Monetary Fund, the World Bank, and the Asian Development Bank. It conducts a thorough assessment of Pakistan's current state-owned

¹¹ 'State Life Insurance Corporation of Pakistan vs. Commissioner Insurance, SECP' 2017 CLD 1515 SECP

¹² 'Habib Bank Limited vs. Honorable Justice Imran Inayat Butt' 2013 CLD 812 SECP

enterprises (SOEs) portfolio, with the primary goal of determining whether SOEs should be retained, privatized, or liquidated. Furthermore, the report suggests a path to enhance the governance and performance of SOEs through institutional reforms and policy measures. Employing a triage methodology based on public policy framework, market failure, and financial viability, the report classifies SOEs into distinct groups. Additionally, it includes an action matrix and approximate schedules to implement the triage findings.¹³

The above mentioned are a few examples among many of corporate failures of SOEs in Pakistan due to lack of a legislative and regulatory framework of SOEs, weak compliance with CG rules and laws, poor enforcement mechanism, heterogeneous governance regimes, ineffective accountability framework, ineffective & weak BOD structure, poor internal controls system, political interference, nepotism, etc.

In a research paper, 'Governance related issues of State Owned Organizations' Director General of Defence Services Audit, Department of Auditor General of Pakistan Faisal Saeed Cheema debates on the poor corporate governance in SOEs due to lack of legislative and regulatory frameworks and gives suggestions and recommendations to make improvements in the CG laws for the better results.¹⁴

In a Ph.D. thesis, 'Corporate governance in Pakistan: beyond a minimalist approach' Samza Fatima says that state regulators like SECP are responsible for regular updation of CCG. Her thesis investigates the corporate governance system in Pakistan and its influence on the performance and accountability of listed companies. It contends that the current corporate governance framework in Pakistan adopts a minimalist perspective, concentrating primarily on adhering to formal rules and

¹³ Ibid n (2)

¹⁴ Research paper, 'Governance related issues of State Owned Organizations' Director General of Defence Services Audit, Department of Auditor General of Pakistan Faisal Saeed Cheema can be accessed at <https://eap.gov.pk/Download/Docs/Files/Articles%20and%20Reports/2020/Issues%20and%20Recommendations%20on%20CG%20in%20SOEs.pdf>

regulations, rather than emphasizing substantial outcomes and the interests of stakeholders. To address this, the thesis suggests adopting a comprehensive and inclusive approach to corporate governance, encompassing socio-cultural, political, and economic factors that impact the conduct and expectations of corporate actors and stakeholders in Pakistan. Furthermore, the paper provides policy recommendations and highlights potential areas for future research. She also asserts that the regulations and laws pertaining to state-owned enterprises (SOEs) established by regulators should be unambiguous, devoid of any confusion, and should not duplicate the provisions of other corporate laws. It is crucial to enact regulations and laws that facilitate the effective implementation of corporate governance (CG) laws within SOEs in Pakistan. Without being actively enforced, laws may merely remain theoretical without practical value.¹⁵

In a research paper, 'Corporate Governance- Issues and Challenges in Pakistan' Beenish Ameer identified numerous legal issues and challenges related to corporate governance and furnished recommendations to improve the governance system.¹⁶

Lene Christensen holds the view that state-owned enterprises (SOEs) are distinct from public agencies due to their unique organizational structure and purpose. Unlike public agencies that primarily engage in administrative functions, SOEs fulfill non-commercial roles in areas such as healthcare, infrastructure, and the environment.¹⁷

Caldwell & Linda A. Hayes posit that state-owned enterprises (SOEs) can enhance their governance procedures by adopting stewardship principles. This can be achieved through various means, such as achieving long-term value creation, ensuring board independence, practicing

¹⁵ Samza Fatima, "Corporate Governance in Pakistan: Beyond a Minimalist Approach." PhD diss., University of Bedfordshire, 2016. <https://uobrep.openrepository.com/handle/10547/621847>.

¹⁶ International Journal of Academic Research in Business and Social Sciences April 2013, Vol. 3, No. 4 ISSN: 2222-6990 79 www.ijarbs.com/journal Corporate Governance- Issues and Challenges in Pakistan by Beenish Ameer

¹⁷ Lene T.Christensen, "The return of the hierarchy: SOEs in marketisation" in International Journal of Public Sector Management, 2015, page no.309, Last accessed on March 21, 2023

transparent disclosure and reporting, and implementing effective risk management.¹⁸

DiMaggio and Powell argue that the Institutional theory places emphasis on the importance of organizational legitimacy. They contend that state-owned enterprises (SOEs) can establish their legitimacy and secure their survival by adhering to established institutional norms and practices. When these SOEs harmonize their framework, actions, behavior, and procedures with social expectations, they can earn the trust of major stakeholders, mitigate risks, and operate efficiently within their institutional environment.¹⁹

Fayyaz Yaseen contends that state-owned enterprises (SOEs) might encounter challenges related to transparency and accountability, primarily due to the comparatively lenient reporting and disclosure requirements they often face when compared to private enterprises. This deficiency in transparency could lead to a lack of information regarding SOEs' activities, financial position, and decision-making process. Consequently, it becomes difficult for private competitors to gauge the equity of the competitive landscape. Lack of transparency in SOEs can result to a lack of information, both financial and non-financial, and can adversely affect the decision making process.²⁰

Above findings validate the importance of this thesis, confirming the relevance and significance of corporate governance principles on SOEs' performance, ultimately impacting a country's economy. This thesis presents a comprehensive investigation into corporate governance in

¹⁸ Caldwell, Cam, Linda A. Hayes, Patricia Bernal, & Ranjan Karri, "Ethical stewardship – implications for leadership and trust." *Journal of business ethics* 78 (2008): 153-164. Can be accessed at https://www.researchgate.net/publication/5149139_Ethical_Stewardship_-_Implications_for_Leadership_and_Trust/link/5773a41d08ae47ba06e223e/download , Last accessed on April 23, 2022

¹⁹ DiMaggio, P. J., & Powell, W. W. (1983). "The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields." *American Sociological Review*, 48(2), 147-160. Last accessed on April 25, 2022

²⁰ Fayyaz Yaseen, "Social Accountability in Pakistan: Challenges, Gaps, Oppertunities, and the Way Forward", Page No. 5 to 8, First Edition, publication of Sustainable Development Policy Institute, SDPI, May 2013, can be accessed at

<https://sdpi.org/indaweb/publications/files/W-113.pdf> , Last accessed on May 27, 2022

Pakistan's State-Owned Enterprises. The study encompasses legal, theoretical, and practical aspects.

1.3. Significance of the study:

Corporate Governance in SOEs has become significant after the post-2008 financial crisis in both developing and developed countries due to financial distress, corporate scams, and privatization of SOEs. These scandals clearly show that without effective CCG of SOEs, insiders whether they are directors or public officers will steal the companies at the cost of investors and stakeholders. SOEs in Pakistan are facing financial failures, losses, and privatization due to their ineffective and weak CG framework. Due to the increase in demand for effective CG principles. The rationale behind this study is to provide an analysis of the CG framework and offer some suggestions regarding these SOEs in Pakistan. Existing legal literature suggests the following factors are responsible for the SOEs failure and poor governance:

1. Lack of Legislative and regulatory framework for SOEs in Pakistan.
2. Poor regulatory enforcement and mechanism to implement CG laws in SOEs in Pakistan.
3. Poor accountability mechanism due to which accountable directors or public officers can't be penalized.
4. Absence of effective internal controls in SOEs for check and balance as suggested in CG laws.
5. Political interference in the appointment of independent NEDs and EDs in SOEs is also against the CG principles and laws.
6. Ineffective BOD due to their unclear mandate and wrong induction method being opposite to the CG principles and laws.
7. Lack of transparency in disclosure practices of SOEs in Pakistan and are not complying with IFRS and IAS.
8. Privileged position of SOEs creating its own monopoly leaving an adverse impact on the free market and corporate sector in Pakistan.

Hence this study is required to examine the effectiveness of the CG framework and laws by identifying their weaknesses and exploring the opportunities for improvements and reforms.

1.4. Research Questions:

Following are some important questions that will be answered through this study:

1. What is the significance of CCG for listed SOEs in Pakistan? What are the requirements for the effective and efficient CCG for listed SOEs in Pakistan?
2. How the enforcement and implementation mechanism of SOEs related to CG laws could be improved? Whether or not current CCG sufficient for the effectiveness of SOEs?
3. Are State Owned Enterprises Legitimate? This question of legitimacy is twofold: first pertains to the legitimate/illegitimate exercise of the government's shareholding rights in a business organization. Second pertains to the SOEs' organizational structure in relation to the central government.
4. What are the legal prospects on the problem of separation of ownership/shareholding and control in SOEs in Pakistan?
5. Whether or not a privileged position of SOEs in Pakistan is not leaving an adverse impact on the free market and competition by creating its own monopoly? And is this not a violation of the Competition Act 2010?
6. What are the future perspectives of SOEs' reforms in Pakistan?

1.5. Research Methodology:

In term of methodology qualitative approach is used, which consist of examination and interpretation of selective books, research articles, laws and regulations, case laws, in order to identify the loopholes, lacunas in the Pakistani Code of Corporate Governance (CCG), the legislative, and

regulatory framework for SOEs in Pakistan and to identify SOEs' issues and explore the solutions for them.

The main reason behind choosing the qualitative method is that it recognizes the existence or nonexistence of something and it is not associated with statistical investigation or quantification. Data is collected through both primary and secondary sources. Primary sources include Laws, Statutes, Code of Corporate Governance, Government publications, World Bank reports, Cases, and reported judicial decisions. Secondary sources include Books, Articles, Websites and Newspapers.

CHAPTER 2: LEGAL FRAMEWORK OF PAKISTAN

CORPORATE GOVERNANCE RELATED TO SOES

2.1. Development of Corporate Laws in Pakistan:

Corporate laws in Pakistan can be traced back to the 16th century when the East India Company, which became one of the biggest and the most dominant corporations in history.²¹ During the 17th century, Joint stock trading companies began trading on behalf of merchants. Royal charters or Special Acts of Parliament were the only methods that were used to incorporate such corporations. In 1720, the collapse of the South Sea Company led to the enactment of the Bubble Act of 1720, which curtailed the use of such corporations for more than a hundred years. In 1825, Bubble Act was repealed due to its harsh feature of unlimited liability, uncertainties, and unfair results. Thereafter, modern company law begins.²²

In 1844, Joint Stock Companies Act prohibited large unincorporated companies and permitted the formation of the joint stock company without a Royal Charter or Special Act of Parliament. Later, the concept of limited liability was introduced in the Limited Liability Act of 1855. In sub-continent/ Pakistan, the first Indian Companies Act was enacted in 1850. This was followed by the later consolidated Acts of 1856 and 1857 which granted the privilege of limited liability to joint stock companies, except banking and insurance companies. British rulers used the 1844 Act as a tool to run the affairs of the companies. Companies Act of 1862, which bears the short title “Companies Act”, was enacted and consolidated earlier Acts. Later a comprehensive Act of 1866 was passed for consolidations and amendments in the laws relating to the incorporation, regulation, and winding up of trading companies. Besides this, other amending Acts were

²¹ Saeed, Syed Kashif, “Corporate Governance in Pakistan”, Islamabad: Higher Education Commission, 2018, Page No. 39, Last accessed on April 19, 2021, can be accessed at HEC web

<http://hec.gov.pk/english/bitstream/123456789/2532/1/Corporate%20Governance%20in%20Pakistan.pdf>,

²² Nyazee, Imran Ahsan Khan, “Company Law” (Includes Companies Act, 2017), Islamabad, Federal Law House in 2013, Page No. 41-42

passed in 1895 and 1895. In 1908, in England, another consolidated Act was enacted which introduced the feature of a private company and was followed by 18 amending statutes. This was later enacted in India, in the form of the Act of 1910.²³

Companies Act 1913²⁴ was enacted in the subcontinent which was quite similar to the former English Companies Consolidated Act of 1908. Later, several amendments were made to the Companies Act 1913 in 1914, 1915, 1920, 1926, 1930, and 1932. After 1947, Pakistan got independent, several laws were enacted to cater to the needs of its economy including the Companies Act 1958, the Securities and Exchange Ordinance 1969, the Companies (Managing Agency and Election of Directors) Order 1972, and the Companies (shifting of Registered Office) Ordinance 1972. A Company Law Commission was established in 1959, to make these corporate laws more effective and efficient. Recommendations of this commission were not considered and implemented and as a result Companies Act, 1913 continued till the enforcement of the Companies Ordinance 1984.²⁵ In 1984, the Companies Ordinance 1984,²⁶ repealed all these laws except the Securities and Exchange Ordinance 1969. Companies Ordinance 1984 was the first corporate law being originated from British Law which served more than 30 years for regulating the corporate sector of Pakistan. Several amendments regarding insider trading, merger and acquisition, and single member company were also made.

Ministry of Finance (MOF), Corporate Law Authority (CLA), and the State Bank of Pakistan (SBP) were the main regulators responsible for regulating and enforcing corporate governance in Pakistan before the Securities and

²³ Ibid

²⁴ Companies Act 1913 was inherited from the British Colonial Rule which provided legal framework for the companies operating in the then Sub-continent. Act No. VII of 1913 passed by Governor General of India in council by his assent on the 27th March, 1913, can be accessed at

<https://www.icsi.edu/media/portals/36/The%20Company%20Act%201913.pdf>, Last accessed on June 20, 2022

²⁵ Ibid n (16), Page No. 39

²⁶ "Companies Ordinance, 1984" National Assembly of Pakistan. Can be accessed at <https://srs.gov.pk/uploads/documents/1437139221777.pdf>, Last Accessed on June 20, 2022.

Exchange Commission of Pakistan (SECP).²⁷ In 1997, SECP was established under SECP Act 1997, to regulate the companies operating in Pakistan. Over the period of more than thirty years, the corporate sector of Pakistan witnessed changes in the economic environment. The primary function of SECP being a regulator, was to mitigate the risk of internal and external shocks, which was only possible through making improvements in the rules and regulations. Lastly, the Company Act 2017, was enacted on 31st May, 2017.²⁸

2.2. Definition of Corporate Governance:

The sphere of Corporate Governance is so vast that it does not have any single or particular definition. There is no consensus among scholars on the issue of a single generally accepted definition. Different writers, authors, schools of thought, organizations, institutes, professionals, and experts have defined it differently from their own perspectives. Some authors have defined it in a broader way, and others have defined it in a narrower sense.²⁹

Broader definitions of Corporate Governance are related to the structure, cultures, systems, and processes that are necessary for the effective operations of the corporations. Corporate Governance has been broadly defined in many ways. According to Cadbury Report, "Corporate Governance is a framework through which companies can be directed and controlled".³⁰ Thomas Clark has related Corporate Governance to the "exercise of power in corporate entities".³¹ Monks and Minow has defined it as "a relationship among various participants in determining the direction and performance of corporations".³² John Farrar defines Corporate Governance as: "Corporate Governance involves considering the legitimacy

²⁷ Ibid n (39), Page No. 40

²⁸ Ibid n (14), Page No. 4

²⁹ Jill Solomon, "Corporate Governance and Accountability" 4th edition, Wiley 2013

³⁰ The Committee on the Financial Aspects of Corporate Governance, "Report of the Committee on the Financial Aspects of Corporate Governance (The Cadbury Report 1992)" London: Gee and Co. Ltd., 1992, Para 2.5, Last accessed on April 27, 2021, can be accessed at <https://www.frc.org.uk/getattachment/2c12ea0f-bb7-434-434-12e22c1e271a/The-Financial-Aspects-of-Corporate-Governance-the-Cadbury-Code.pdf>

³¹ Thomas Clarke, "Theories of Corporate Governance" (Routledge 2004)

³² Robert Monks and Nell Minow, "Corporate Governance" (3rd edition, Blackwell Publishers 2004)

of corporate power, corporate accountability, and standards by which the corporation is to be governed".³³ So, the broader concept of corporate governance focuses on the relationships amongst the stakeholders of the company.

Narrower definitions of corporate governance have been given by the OECD, "UK Department of Business, Innovations, and Skills", Professor Mulbert, and Sir Adrian Cadbury. OECD defines Corporate Governance as "a set of relationships between a company's management, its board, shareholders, and other stakeholders."³⁴ According to the OECD, the Corporate Governance structure stipulates the distribution of rights and responsibilities among divergent stakeholders in the corporation. Likewise, it additionally specifies the structure through which the company's objectives are established and achieved and monitoring performance."³⁵ Adrian Cadbury defines it as "a whole system of controls both financial, both financial and otherwise, by which a company is directed and controlled."³⁶ The World Bank (1992) defined Governance as: "Governance is a method through which power is exercised in the management of a country's political, economic, and social resources for development."

Perusing the above definitions, following characteristics of corporate governance can be summarized as follow:

- System of controls within the company which could be financial or otherwise
- A system through which a company can be directed and controlled
- A relationship between company's management, board, shareholders, and its stakeholders
- Exercise of power within corporate entities

³³ John Farrar, 'Corporate Governance, Business Judgement and the Professionalism of Directors' (1993) 5(1) Corporate and Business Law Journal

³⁴ Ibid n(15)

³⁵ OECD, Principles of Governance (2004) can be accessed at <http://www.oecd.org/dataoecd/1/33/31557724.pdf> accessed 22 June 2022.

³⁶ Adrian Cadbury, "Report of the committee on the Financial aspect of Corporate Governance" <http://www.ecgi.org/workingpapers/documents/cadbury.pdf>

- Company being a responsible and accountable entity
- A system through which the rights of shareholders & stakeholders are recognized and protected
- A system that protects the investors' return³⁷

To cut the long story short, corporate governance is a framework which deals with the organizational structure, relationship amongst stakeholders, internal governance, accountability, corporate culture, and systems responsible for the effective operation of the corporation. Good governance relies on accountability. In corporate governance, shareholders elect directors to manage the organization's affairs, and these directors are accountable for their actions to ensure transparency and responsible decision-making. This fosters trust and aligns the company's operations with stakeholders' interests.

2.3. Development of Corporate Governance in Pakistan:

The concept of corporate governance looks simpler and unambiguous, but it actually is a complex, broad, extensive, and multi-facet subject and is changing and expanding continuously.³⁸ The corporate governance mechanism seeks the basic objectives of transparency, accountability, fairness, and fair disclosure mechanism to increase and protect investors' return. Different countries have developed their own CG structures to cater to their economic needs. These CG structures in different countries are dependent on different factors like legal framework, regulatory framework, implementation and enforcement mechanism, patterns of shareholding and financial markets, etc. After the occurrence of major corporate scandals worldwide, like collapse of the energy giant Enron,³⁹ Volkswagen Emission

³⁷ Ibid n(16), Page No.5

³⁸ Andrew Keay "The Enlightened Shareholder Value Principle and Corporate Governance" (Routledge 2013) vii,

³⁹ McLean, Bethany, and Peter Elkind. 2003. "The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron." New York: Portfolio.

Scandal,⁴⁰ Lehman Brothers Scandal,⁴¹ etc the need for improvements in the corporate governance of the companies increased. Pakistan is no exception to such scandals, for instance, major scandals in SOEs like PIA, Pakistan Railway, PSO, PTCL, NBP, and OGDCL have encouraged the regulators to improve the system corporate governance of companies by making changes in rules and by improving the enforcement mechanism of corporate laws.⁴²

The corporate governance system of Pakistan has significantly changed over the past three decades in three phases. The first phase (1990 to 2002) was regarding structural formation. For the development of a regulatory framework of capital markets, the Securities and Exchange Commission of Pakistan (SECP) was established in 1997 and superseded the former Corporate Law Authority. First code of corporate governance was drafted in 1999, with the collaboration of ICAP, ICMA, academics, & listed companies. It was based on OECD principles of corporate governance and guidance was taken from the CCGs of UK and South Africa. Law related to listing requirements was also legislated in the same phase by introducing listing regulations, which made it compulsory for all the listed companies on KSE to comply with the code of corporate governance CCG.⁴³ Similarly, the appointment of NEDs to the listed companies was also prescribed in the same phase.⁴⁴

⁴⁰ BBC, "Volkswagen: The scandal explained, December 10, 2015," BBC News, can be accessed at <https://www.bbc.com/news/business-34324772> , Last accessed on June 25, 2022.

⁴¹ Rosalind Z. Wiggins, Andrew Metrick, and Thomas Piontek , "The Lehman Brothers Bankruptcy A: Overview", 2019, Journal of Financial Crises, Volume I, Issue 1, can be accessed at <https://ebscholar.library.yale.edu/cgi/viewcontent.cgi?article=1000&context=journal-of-financial-crises>, Last accessed on June 25, 2022.

⁴² Ibid n(3)

⁴³The Listing Regulations of Karachi Stock Exchange, Section-34, can be accessed at https://www.ma.gov.pk/guidelines_regulations/Listing%20Regulations%20of%20Karachi%20Stock%20Exchange.pdf , Last accessed on September 19, 2021

⁴⁴ Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan, by Faryal Salman and Kamran Siddique based on the interview (held on October 21, 2011) with Etrat Hussain Rizvi, Former Commissioner, Securities and Exchange Commission of Pakistan (SECP).

During the second phase (2002 to 2006), the Pakistan Institute of Corporate Governance (PICG), was established whose main function was to create awareness about the benefits of corporate governance and about the acceptability of the CCG. So the law declared the implementation of the CCG in Public companies and Banking companies.

The third phase (2006 to date) was the time phase when the CCG was implemented in all kinds of companies including listed companies, non listed companies, & public companies. Company Act 2017, Limited Liability Partnership regulations 2017, the companies (incorporation) regulations 2017, and regulations related to non-profit organizations were introduced.⁴⁵ Though the corporate governance environment has changed significantly over the past years, the enforcement mechanism is still not satisfactory and up to the mark. Still there is room for improvements in enforcement mechanisms and changes in rules, as the CCG is not being adopted in its true letter and spirit.

2.4. Significance of Corporate Governance in State Owned Enterprises (SOEs):

SOEs are entities that are partially or wholly, owned and controlled by the government. Besides the government being the major shareholder of SOEs, it also serves some other roles i-e as a regulator, and as a customer. At the same time, these SOEs are held accountable before the government and other public bodies. The rationale of SOEs is different compared to other private corporations as they are not limited to the pursuit of profit maximization and cost-efficiency. Instead, sustainable “public value creation” is one of the primary objectives of SOEs by which it promotes public values like public health, sound economy, equality, infrastructure, environment, etc. John Bryson has defined public value creation as “producing what is either valued by the public, is good for the public, including adding to the public sphere, or both, as assessed against various

⁴⁵ National Assembly of Pakistan, “Company Act, 2017” can be accessed at [https://www.scribd.com/document/391711111/Companies-act-2017/](https://www.scribd.com/document/391711111/Companies-act-2017)

public value criteria”.⁴⁶ While Barry Bozeman has given its definition based on the principles of trust, accountability, legitimacy, and integrity.⁴⁷ Generally, SOE’s main socio-economic objectives are:

1. Building infrastructure in the energy and transport sectors and improving the services industry.
2. Reducing fiscal burdens and risks through their access to the capital markets.
3. Providing job opportunities to the masses.
4. Strengthening transparency & accountability.⁴⁸
5. Establishment of new industries and supporting such industries with subsidies.
6. Distribution of economic power in public & private sectors.
7. Distribution of wealth by delivering goods & services without any discrimination.
8. Strengthening national bargain power in seeking foreign investments (FDIs) by keeping the lower cost of capital⁴⁹ and higher and higher firm valuation.⁵⁰

Corporate governance in SOEs is the strategy through which these objectives can be achieved, by following the OECD principles of accountability, transparency, fairness, and responsibility.⁵¹ Corporate

⁴⁶ John Bryson and Barbara C. Crosby, “Public Value Governance: Moving Beyond Traditional Public Administration and the New Public Management” (2014) 74 *Public Administration Review* 448

⁴⁷ Barry Bozeman, “Public Values and Public Interest: Counterbalancing Economic Individualism” (Georgetown University Press 2007)

⁴⁸ World Bank, “Corporate Governance of State-Owned Enterprises: A Toolkit by The World Bank” page no. 16 can be accessed at <https://openknowledge.worldbank.org/handle/16089/20390>

⁴⁹ Cost of capital is the return required by the investors including debts (creditors + bank loans) and shareholders (preference shareholders). It is made up of cost of debt and cost of equity. Generally cost of debt being cheaper (lower return), because of low risk than equity shareholders.

⁵⁰ Claessens, Stijn and Yurtoglu, B. Burcin, “Corporate Governance and Development: An Update” (May 17, 2012), 2012, Focus 10, Global Corporate Governance Network, IFC., Page No. 17, Last accessed on September 20, 2021 can be accessed at SSRN:

<https://ssrn.com/abstract=2061563>

⁵¹ *ibid*

governance in SOEs is significant because of the following issues and benefits:

1. SOEs sector of Pakistan is critical and crucial for the country's economy. Corporate governance in SOEs will enhance its competitiveness along with the country's economy.
2. Major SOEs like PIA, PSO, OGDCL, NBP, and Pakistan Railway (PR) have been showing weak performances, functionally & economically, or facing privatization for e-g PTCL. Corporate Governance in SOEs will reduce the risks of corporate scandals and failures.⁵²
3. Poor enforcement and compliance mechanism of regulators due to which process of reforms ends up unimplemented or might become unachievable.
4. Good corporate governance in SOEs will smoothen the relationships with all stakeholders.⁵³
5. Professional accountability of SOEs is adversely affected due to nepotism, government interference, the poor conviction rate in corporate crimes, and due to lack of legal and institutional systems.
6. Poor disclosure practices not complying with IFRS standards⁵⁴ will result in misrepresentation in the financial statements of SOEs. Window dressing techniques may mislead the potential users of such information. Proper disclosure is another factor that gives the true picture of SOEs and provides information related to the financial position of SOEs in their financial statements for a better understanding of their potential users and to mitigate the risks of fraud, corruption, and misrepresentation.

To address and fix the above issues of SOEs corporate governance is needed for transparency and accountability. So "The proper governance of

⁵² ibid

⁵³ Ibid

⁵⁴ International Financial Reporting Standards (IFRS) are international standards required to be followed by public companies including SOEs. Pakistan has adapted all effected IFRS standards except IFRS 1 and IFRS 14. <https://www.ifrs.org/used-around-the-world/country-profiles/standards-by-jurisdiction/new-jurisdiction/pakistan/> last accessed, 23June 2022.

companies will become as crucial to the world economy as the proper governance of countries”⁵⁵

⁵⁵ James D. Wolfensohn, President of the World Bank , 1999

CHAPTER 3: THEORETICAL PERSPECTIVES AND LEGAL

FRAMEWORK

3.1. What is SOE and what is not SOE?

The OECD guidelines defined state owned enterprise SOE as a separate legal entity (being separable from public administration), which is directed and controlled by the government.

“Any corporate entity recognized by national law as an enterprise, and in which the state exercises ownership, should be considered as an SOE. This includes joint-stock companies, limited liability companies, and partnerships limited by shares. Moreover, statutory corporations, with their legal personality established through specific legislation, should be considered as SOEs if their purpose and activities, or parts of their activities, are of a largely economic nature.”⁵⁶

However, there is a variety of SOEs having different features of ownership and control. Some SOEs also exercise their control by acquiring non-controlling voting rights via agreements or through special terms and conditions in the Article of Association. These SOEs might be operating in competitive or non-competitive sectors.⁵⁷ SOEs are owned by the state but work on behalf of the general public. State control doesn't mean that the government is legally allowed to interfere or intervene in the day-to-day operations, management, or governance of the company. In fact, the government controls it by being the owner of the majority voting shares. Things become problematic or controversial when the government politicizes

⁵⁶ OECD Guidelines (n 19), Page No.15.

⁵⁷ World Bank, “Corporate Governance of State-Owned Enterprises: A Toolkit by The World Bank” See page no. 26, accessed at <https://openknowledge.worldbank.org/handle/10780/20399>. On the role of non-controlling (NCIs) shareholders see Mark J. Roe, ‘The Institutions of Corporate Governance’ or https://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en,

the control of SOEs by interfering in matters related to management or governance.

As far as “what is not a SOE” is concerned, Lene Christensen has given another definition of SOE:

“SOEs provide public services, but on market-based terms. Their hybridity derives from the combination of state ownership that entitles a sort of publicness or social responsibility combined with legally independence with economic autonomy or even a company form based on private law.”⁵⁸

Lene Christensen believes that SOEs because of their different structure and function are different from public agencies. Functions of these public agencies are of administrative nature, while functions of SOEs are of non-commercial nature like health, infrastructure, environment, etc. To sum up, state ownership is an indicator of SOE but not a determinant. Considering the above definitions, SOEs have the following features:

- SOEs are business entities created for profit maximization or cost efficiency.
- SOEs are business entities that have non-profit objectives or of ‘Public value creation’.
- SOEs are entities that can be directly and indirectly controlled by the state through legal formation, laws, and regulations
- SOEs in pursuit of their public mission provide goods and services (at subsidized prices) to the general public.

⁵⁸ Lene T. Christensen, “The return of the hierarchy: SOEs in marketisation” in *International Journal of Public Sector Management*, 2015, page no.309

3.2. OECD principles of Corporate Governance:

The Organization for Economic Co-operation and Development (OECD), established in 1961, is an intergovernmental economic organization comprising 38 member countries. Its primary objective is to promote economic progress and global trade. It is functioning as a forum for democratic nations with market-based economies. It facilitates the exchange of policy experiences, collaborative problem-solving, identification of best practices, and coordination of domestic and international policies.⁵⁹

Pakistan joined the Organization for Economic Cooperation and Development (OECD) on September 14, 2016, becoming its 104th member, Muhammad Ishaq Dar, was the then Minister for Finance, Revenue, Statistics, and Economic Affairs Division. He gave a statement that previously, only G-20 countries were members of the OECD, later on, it was expanded to include other countries. By the time Pakistan became a member, the OECD had 103 existing members.⁶⁰

OECD Guidelines on Corporate Governance of SOEs is an international benchmark of good practice. The basic principles of OECD are considered as a code of standards worldwide that provide best practices and recommendations for effective governance of SOEs and to promote transparency, and accountability in its operations. These guidelines serve as a valuable reference for governments and SOEs to enhance their governance frameworks, promote transparency, and improve the overall performance of SOEs. By implementing these recommendations, countries can foster an environment where SOEs contribute to economic growth while operating in a transparent, accountable, and efficient manner. OECD guidelines related to SOEs cover following areas:

1. Legal and Regulatory Framework for SOEs
2. The Role of a State as Owner

⁵⁹ Official website of OECD, can be accessed at <https://www.oecd.org/about/partners/>

⁶⁰ Times of Islamabad, "Pakistan becomes 104th member of OECD", issued on 27 Sep, 2016, can be accessed at, <https://timesofislamabad.com/27-Sep-2016/pakistan-becomes-104th-member-of-oecd/>, Last accessed on October 5, 2021.

3. Equitable Treatment of Shareholders
4. Relations with Stakeholders
5. Transparency and Disclosure⁶¹
6. Responsibility of SOE boards
7. Enhancing internal controls and risk management
8. Promoting accountability and performance management⁶²
9. Ensuring effective financial oversight
10. Encouraging the use of private sector practices⁶³

3.2.1. Legal & Regulatory framework for SOEs in Pakistan:

The establishment of an effective legal and regulatory framework is the primary prerequisite for the corporate governance of SOEs recommended by OECD guidelines. It not only avoids market distortions but also ensures a competitive environment for SOEs and Private Sector Companies (PSCs). This regulatory framework demands clear separation in the State's ownership function. Furthermore, it requires uniform application and implementation of corporate laws and regulations to SOEs and other business entities without giving any privilege to SOEs.⁶⁴

In Pakistan, the regulatory framework is divided into two branches:

- Institutional framework
- Legislative framework

The institutional framework includes the Federal government of Pakistan as the owner of SOEs having majority voting shares. About seventeen ministries in Pakistan are responsible for the administration of 190 SOEs of different sectors including Development Finance Institutions (DFIs), Public

⁶¹ OECD, "OECD's Corporate Governance guidelines related to Transparency and Disclosure Practices of State Owned Enterprises" can be accessed at <https://www.oecd.org/corporate/Transparency-Disclosure-Practices-SOEs.pdf>

⁶² OECD "OECD Guidelines on Anti-Corruption and Integrity in State Owned Enterprises" can be accessed at <https://www.oecd.org/daf/bo/Guidelines-Anti-Corruption-Integrity-State-Owned-Enterprises.pdf> AND

<https://mneguidelines.oecd.org/2012-Annual-Report-MNEs-Practices-2012.pdf>

⁶³ OECD, "OECD Guidelines on Corporate Governance of SOEs", 2015 Edition <https://www.bicg.eu/wp-content/uploads/2017/01/OECD-2015.pdf>

⁶⁴ Ibid, n(25), Page no.17

Sector Companies (PSCs), Banks, and WAPDA. But mostly these SOEs are related to three ministries including the Ministry of Finance, the Ministries of Industries and production, & the Ministry of water and power. Securities Exchange Commission of Pakistan (SECP), being a regulatory authority, regulates the PSCs registered under the Companies Ordinance, 1984.⁶⁵

The legislative framework does not include any particular or specific legislation for SOEs in Pakistan. However, it may include the rules made by SECP regarding public sector companies' i-e Public Sector Companies (Governance) Rules 2013,⁶⁶ which regulates the companies owned by the government directly or indirectly. The development of these rules was considered the first step heading toward improving the governance of SOEs, which help in identifying the clear roles and responsibilities of different stakeholders responsible for the governance and decision-making of SOEs.

3.2.2. Role of a state as owner:

The role of the state as the owner is also enshrined in the OECD principles. To make sure that the SOEs are being governed in a transparent and accountable manner in a professional and effective way, the state must act as an informed and active owner by establishing a clear and consistent ownership policy. For example, the government needs not interfere in the daily management affairs of SOEs; the boards of SOEs need to be independent while exercising their duties and responsibilities and the state must respect it.⁶⁷

⁶⁵ Faisal Saeed Cheema, "Governance Related Issues of Stated-Owned Enterprises in Pakistan" Director General Defence Services Audit, Department of the Auditor General of Pakistan, Last accessed on November 6, 2021, can be accessed at the website of AGP at <https://agp.gov.pk/SiteImage/Misc/Files/Article9Governance%20Related%20Issues%2045-53s.pdf>

⁶⁶ "Public Sector Companies (Governance) Rules, 2013" can be accessed at <https://www.officialgazette.gov.pk/content/uploads/2019/09/psc-rules-amended-up-to-april-21-2017.pdf>

⁶⁷ OECD, "OECD Guidelines on Corporate Governance of State-Owned Enterprises", 2015 Edition © OECD 2015 page 17 can be accessed at <https://www.oecd.org/daf/ineq/soue/2015-guidelines-on-corporate-governance-of-state-owned-enterprises.pdf>

In Pakistan, the State-Owned Enterprises (Governance and Operations) Act 2021 is the relevant law. The federal government acts as an “informed and active shareholder”⁶⁸ of the SOEs and plays a significant role in the corporate governance in many ways:

- By formulating the objectives and goals of the SOEs, in liaison with broader goals and policies of the government.
- By monitoring the performance of SOEs to make sure that these are performing in accordance with the set objectives and goals.
- By providing financial support to the SOEs by granting loans, grants and subsidies.
- By ensuring accountability by making SOEs accountable to their actions in front of the government and the public. Such accountability role of the state ensures that operations of SOEs are being operated in an economic, effective, and efficient manner.

The overall role of the state in SOEs governance in Pakistan is to assure that SOEs are functioning in the best interest of the public and the country’s economy.

3.2.3. Equitable Treatment of Shareholders:

SOEs should ensure equitable treatment of all shareholders, including minority shareholders. This includes protecting their rights, providing equal access to information, and ensuring fair treatment in decision-making processes. This also includes sharing of information with all shareholder through an active policy of communication and consultation without any discrimination. The rights of minority shareholders must be safeguarded against unfair behavior from controlling shareholders, whether they act directly or indirectly. Barriers to cross-border voting should be removed. The protocols and systems for general shareholder meetings should ensure fair

⁶⁸ State-Owned Enterprises (Governance and Operations) Act 2021, Section 4, can be accessed at https://www.finance.gov.pk/SOEs_Act_2022.pdf

treatment for all shareholders. Company procedures should not unnecessarily hinder or make it costly to cast votes.⁶⁹

In the context of State-Owned Enterprises (SOEs) in Pakistan, it is crucial to prohibit insider trading and abusive self-dealing. Insider trading refers to the illegal practice of trading securities based on non-public, material information, giving the trader an unfair advantage. Abusive self-dealing, on the other hand, refers to actions taken by individuals in positions of authority within the corporation for their personal gain at the expense of the company.

To ensure transparency and accountability within SOEs, it is essential to implement regulations that require board members and key executives to disclose any material interest they may have in transactions or matters directly impacting the corporation. This disclosure should cover not only direct interests but also indirect interests or those held on behalf of third parties. By doing so, potential conflicts of interest can be identified and appropriate measures can be taken to address them.⁷⁰

In Pakistan, Securities Act 2015, address the issue of insider trading by providing. It defines insider trading⁷¹ and establishes penalties for individuals⁷² involved in such activities. These provisions aim to discourage individuals from using undisclosed, important information to gain personal advantages in securities trading.⁷³ Moreover, the Companies Act mandates the disclosure of interests in transactions by directors and officers. It specifically focuses on the disclosure of interests by them, requiring them to reveal any direct or indirect interests they may have in proposed transactions or arrangements with the company. Though, this is not

⁶⁹ OECD, "OECD Guidelines on Corporate Governance of State-Owned Enterprises", 2015 Edition © OECD 2015, Page 22, can be accessed at <https://www.oecd.org/gov/2017/07/OECD-2015.pdf>, Last accessed on April 15, 2023

⁷⁰ Ibid, n (25), Page No. 20

⁷¹ Securities Act, 2015, Section 128

⁷² Ibid, Section 159

particularly for SOEs but it can be extended to directors of SOEs, to ensure that the board is aware of potential conflicts of interest.⁷⁴

The Securities and Exchange Commission of Pakistan (SECP) plays a vital role in regulating corporate governance practices, including those concerning SOEs. The SECP issues various guidelines related to corporate governance issues on periodical basis. SECP has also issued codes of corporate governance, such as the Code of Corporate Governance for Listed Companies, which also applies to SOEs. These SECP guidelines emphasize the disclosure of material interests by board members and key executives, emphasizing their duty to act in the corporation's best interests and avoid self-dealing.

By complying with these corporate laws and regulations, SOEs in Pakistan are obligated to establish robust mechanisms for disclosing and managing conflicts of interest. These measures promote transparency, accountability, and good governance practices within SOEs, ensuring that the rights of shareholders are protected, and fostering an environment of fair business practices within the sector.

In Pakistan, there have been instances of investigation and prosecution related to insider trading. As an example, during the fiscal year 2016, regulatory authorities issued 32 notices to listed companies, requesting explanations for unusual price and volume fluctuations in their securities. Among these cases, four were referred to adjudication, indicating that further investigation was warranted. Additionally, one case was forwarded for criminal prosecution, suggesting that there was evidence of wrongdoing in that particular instance. These actions demonstrate the commitment of regulatory bodies to address insider trading and enforce accountability within the securities market in Pakistan.⁷⁵

⁷⁴ Section 205 to 209 of Companies Act, 2017

⁷⁵World Bank, "Report on the observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Pakistan", 2018, published by The World Bank, Page No. 21, can be accessed at the website of World Bank at <https://documents1.worldbank.org/curator/en/372715380000223999/pdf/Corporate-Governance-Country-Assessment-Pakistan.pdf> , Last accessed on July 16, 2022

3.2.4. Ensuring Transparency and Disclosure:

Transparency is a key principle in the governance of SOEs. OECD guidelines recommend that SOEs disclose relevant information to stakeholders, including financial performance, ownership structure, and major risks.⁷⁶ This promotes accountability and allows for effective monitoring of SOEs activities. Under these guidelines, SOEs are supposed to report any material financial or non-financial information to the general public, as per standards which are internationally recognized. This particularly include all SOEs activities which are carried out in the Public Interest with respect to its capacity and size.⁷⁷

For instance, to disclose information related to the governance, structure, voting rights of the enterprise, CG policies and their implementation processes. Another example is to disclose information related to remuneration and salaries of key executives and members of board. The enterprise should provide a transparent and easily understandable statement to the public regarding its objectives and how it is fulfilling them. The structure of governance, ownership, and voting within the enterprise should also be disclosed, including details about any corporate governance code or policy in place, as well as the processes for its implementation. This information should shed light on how the enterprise is organized, who holds ownership stakes, and how decision-making powers are allocated.⁷⁸

Additionally, information regarding board members should also be provided, including their qualifications, the process of their selection, and any policies related to board diversity. The disclosure should include the roles held by board members on other company boards and whether they are considered independent by the SOE board. This transparency ensures that stakeholders have a clear understanding of the expertise and independence of the individuals responsible for governing the enterprise.

⁷⁶ Ibid, n(49), Page 24 and 25

⁷⁷ OECD, "OECD Guidelines on Corporate Governance of State-Owned Enterprises", 2015 Edition © OECD 2015, can be accessed at page no. 24, Chapter VI, Transparency and Disclosure, page no. 24

⁷⁸Ibid

These guidelines also suggests to prepare financial statements as per accounting standards and should be subject to an independent external audit without any bias and interference of the state.⁷⁹

These legal requirements for SOEs will stem from a combination of various sources, including:

- SOE-specific laws: Laws specifically enacted to govern State-Owned Enterprises, outlining their rights, responsibilities, and governance structures.⁸⁰
- Applicable company laws: General company laws that apply to all types of companies, including SOEs, and govern aspects such as incorporation, shareholder rights, and corporate governance.⁸¹
- Accounting laws: Laws and regulations governing financial reporting and disclosure requirements, ensuring that SOEs comply with standardized accounting practices and provide accurate financial information. For instance, International Financial Reporting Standards (IFRS) is a globally recognized set of accounting standards developed by an independent body i-e International Accounting Standards Board (IASB), used by companies in many countries around the world, mainly including the European Union and several other jurisdictions.⁸² Similarly, Generally Accepted Accounting principles (GAAP) refers to a set of accounting principles, standards, and procedures used in the United States. It is developed and maintained by the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC).⁸³

⁷⁹ Ibid

⁸⁰ National Assembly of Pakistan, "State Owned Enterprises Act, 2023", Last accessed on December 1, 2021, can be accessed at

https://nla.gov.pk/uploads/documents/62a03616a27eb_952.pdf,

⁸¹ Companies Act, 2017

⁸² ACCA official website "ACCA Global", can be accessed at

<https://www.acca.int/education/global/member/regulation/auditing-standards/reporting-international-standards.html>, Last accessed on December 5, 2021 or visit IFRS website at, <https://www.ifrs.org/>

⁸³ Financial Accounting Standards Board (FASB) Can be accessed at

<https://www.fasb.org/>, or Forbes ADVISOR, Editorial, "Generally Accepted Accounting Principles (GAAP) Guide" by Chauncey Crail, Kelly Main, lastly updated on September 09,

- Public finance laws: Legislation that pertains to the management of public funds and public expenditure, guiding the financial operations and decision-making of SOEs.
- National Corporate Governance codes: Codes of corporate governance that apply to both private and public companies, including SOEs, aiming to establish principles and best practices for effective corporate governance. For example Code of Corporate Governance, 2012 which was revised in 2017.⁸⁴
- Listing requirements: If the SOE is publicly traded and listed on a stock exchange, it must adhere to specific listing requirements and regulations set forth by the exchange to ensure transparency, disclosure, and fair treatment of shareholders. In the context of law in Pakistan, the SOEs are governed by the State-Owned Enterprises (SOE) Governance & Operations Act, 2023⁸⁵, which was enacted to improve the performance and accountability of SOEs in Pakistan. It also prescribes the roles and responsibilities of the government, the board of directors, and the management of SOEs. State-Owned Enterprises (SOEs) that are enlisted on the Pakistan Stock Exchange (PSX) must adhere to the PSX Rule Book, which encompasses guidelines and directives concerning the listing, trading, clearing, settlement, risk management, and surveillance of securities on the PSX. This rule book further outlines the specific requirements, protocols, and steps involved in the process of listing SOEs on the PSX.⁸⁶

2022, can be accessed at https://www.forbes.com/advisor/business/generally-accepted-accounting-principles-gaap-guide/#what_is_gaap_section

⁸⁴ PWC, "The Listed Companies (Code of Corporate Governance) Regulations, 2019; A new governance regime" 2019, Last accessed on September 10, 2021, can be accessed at [https://www.pwc.com.pk/en/assets/documents/AIF%27s%20document%20on%20the%20listed%20Companies%20\(Code%20of%20Corporate%20Governance\)%20Regulations,%202019.pdf](https://www.pwc.com.pk/en/assets/documents/AIF%27s%20document%20on%20the%20listed%20Companies%20(Code%20of%20Corporate%20Governance)%20Regulations,%202019.pdf)

⁸⁵ The State-Owned Enterprises (SOE) Governance & Operations Act, 2023, can be accessed at https://www.bareq.gov.pk/SOEs_Act_2023.pdf, last accessed on May 6, 2023

⁸⁶ PSX | Regulations | Legal Framework - Pakistan Stock Exchange Limited can be accessed at, https://www.psx.com.pk/psx/tremis/psx/tremis/Psx_Rulebook_2023.pdf, last accessed on May 6, 2023

- Public information disclosure Acts: Acts or regulations that govern the disclosure of information by public entities, including SOEs, ensuring transparency and access to information for the public.

These various legal requirements provide a comprehensive framework for the governance, disclosure, financial reporting, and accountability of SOEs, ensuring that they operate in accordance with applicable laws and regulations.⁸⁷ In Pakistan, several laws including State-Owned Enterprises (Governance and Operations) Act 2023, Companies Act 2017, Accounting Standards by ICAP,⁸⁸ Pakistan Stock Exchange (PSX) Regulations⁸⁹ address the transparency and disclosure issues of SOEs.

3.2.5. Strengthening Boards of Directors:

Effective boards of directors play a crucial role in the governance of SOEs. The OECD guidelines stress the importance of professional and independent boards that act in the best interests of the SOE. They recommend establishing clear criteria for board appointments, ensuring diversity and expertise, and promoting transparency in board decision-making. According to these guidelines the BOD should possess the necessary authority, competence, and their objectives must have clarity to strategically guide and monitor the management.⁹⁰

These OECD guidelines suggests that the Board needs to be fully accountable to the owners and should be held responsible for their actions. A clear mandate needs to be assigned to the Board of SOEs by assigning

⁸⁷ OECD (2020), "Transparency and Disclosure Practices of State-Owned Enterprises and their Owners", <http://www.oecd.org/corporate/transparency-disclosure-practices-soes.pdf>.

⁸⁸Institute of Chartered Accountants of Pakistan (ICAP), "Twelve Accounting standards governed by Institute of Chartered Accountants of Pakistan (ICAP)", Last accessed on October 3, 2021, can be accessed at <https://bcaaccountants.com/accounting-standards-in-pakistan/>.

⁸⁹ Pakistan Stock Exchange (PSX) Regulations can be accessed at, https://www.psx.com.pk/psx/themes/psx/assets/JanBoard_16_19_2019.pdf, Last accessed on October 4, 2021

⁹⁰OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition © OECD 2015, Page No. 26, can be accessed at March 16, 2023, , last accessed on October 8, 2021

clear roles to them through their domestic legislation for instance company law. This board needs to carry out all their functions related to supervision of management. They should have power to set remunerations of executives, and to appoint and remove CEO in the best interest of the enterprise (SOE).⁹¹

These OECD guidelines also considers the separation of roles as the best practice by making Chairperson to be independent from the Chief Executive Officer (CEO). This separation helps to ensure a balance of power, prevent conflict of interests, and promotes independent decision making within the SOEs.

These OECD guidelines further requires boards of SOES to establish specialized committees that consist of independent and competent members to assist the full board in carrying out its responsibilities, specifically in areas such as audit, risk management, and remuneration. The purpose of establishing these specialized committees is to improve the overall effectiveness of the boardroom while also ensuring that the full board maintains its ultimate accountability.⁹²

By following the OECD guidelines, SOEs can enhance their governance structures and ensure that the boards of directors effectively carry out their responsibilities to drive the success and sustainability of the enterprises. In Pakistan, Companies Act 2017, Code of Corporate Governance (CCG) issued by SECP, Public Sector Companies (Corporate governance Rules) 2013,⁹³ Securities Act 2015 address the issues such as independence of Board,

⁹¹ OECD (2021), "Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices", 2021, Last accessed on April 21, 2023, can be accessed at, <https://www.oecd.org/corporate/ownership-and-governance-of-state-owned-enterprises-a-compendium-of-national-practices.htm>.

⁹² Asian Development Bank, Technical Assistance Report: "Pakistan : Supporting State-Owned Enterprise Corporate Governance and Performance", Mandaluyong City, Philippines, Asian Development Bank, October 2021, can be accessed at <https://www.adb.org/sites/default/files/project-documents/35185/35185-201-001-001.pdf>, lastly accessed on May 25, 2022

⁹³ Public Sector Companies (Corporate governance Rules) 2013 can be accessed at <https://www.secp.gov.pk/wp-content/uploads/2019/06/PSCRules-2013-2014-revised-edition-to-april-21-2019.pdf>, last accessed on May 26, 2022

Board structures, competence and qualification of directors, separation of roles, duties and responsibilities of directors and prohibition of insider trading.

3.2.6. Enhancing Internal Controls and Risk Management:

SOEs should establish robust internal control systems and risk management frameworks to ensure effective operations and prevent fraud or corruption. The OECD guidelines recommend implementing sound internal control mechanisms, conducting regular risk assessments, and ensuring appropriate reporting and oversight.⁹⁴ These guidelines suggests to implement reporting systems that enable the ownership entity to regularly monitor, audit, and evaluate the performance of state-owned enterprises (SOEs). These reporting systems also serve to oversee and monitor the SOEs' adherence to relevant corporate governance standards.⁹⁵

OECD guidelines on Anti-corruption and integrity and prevention of corruption considers the risk management system within a SOE as an essential part of its strategy and the attainment of predetermined objectives. It encompasses a well-structured and comprehensive set of internal controls, ethics, and compliance measures that are specifically designed and continuously maintained based on regular and customized risk assessments. These internal controls are designed to mitigate and manage identified risks effectively. They provide guidelines, policies, and procedures to ensure compliance with applicable laws and regulations, ethical standards, and organizational policies. These controls promote ethical behavior and ensure that the SOE operates within legal and regulatory frameworks. These measures include promoting transparency, accountability, and integrity throughout the organization.⁹⁶

⁹⁴ OECD, "OECD Guidelines on Corporate Governance of State-Owned Enterprises", 2015 Edition © OECD 2015, Page No. 26

⁹⁵ Ibid, Page No. 41

⁹⁶ OECD (2019), Guidelines on Anti-corruption and Integrity in State-Owned Enterprises, Page No. 23 & 24, can be accessed at <https://www.oecd.org/dac/governance/anti-corruption-integrity-guidelines-soe-2019/>

In Pakistan, the principles outlined in the guidelines and the OECD guidelines on anti-corruption and integrity are relevant and compatible with the legal framework governing State-Owned Enterprises (SOEs). The Companies Act, 2017 provides provisions for governance, including internal controls, risk management, and reporting requirements, which align with the recommended principles. The Securities and Exchange Commission of Pakistan (SECP) issues guidelines to promote good governance and integrity in companies, including SOEs. The Public Procurement Rules focus on transparency and accountability in procurement processes. Anti-corruption laws, such as the National Accountability Ordinance, 1999,⁹⁷ and the Prevention of Corruption Act,⁹⁸ aim to combat corruption within public sector entities. While these general principles align with Pakistani law, it is important to refer to specific legislation and regulations for a comprehensive understanding of the legal framework for SOEs in Pakistan.

3.2.7. Promoting Accountability and Performance Management:

The OECD guidelines emphasize the need for performance-oriented cultures in SOEs. This includes setting clear performance objectives, implementing performance management systems, and establishing appropriate monitoring and evaluation mechanisms to ensure accountability.⁹⁹

3.2.8. Ensuring Effective Financial Oversight:

As per OECD guidelines SOEs should maintain accurate and reliable financial reporting and ensure effective financial oversight. The guidelines recommend adherence to accounting standards, independent audits, and establishing appropriate mechanisms for financial reporting and oversight.

⁹⁷ "NAB Ordinance, 1999" can be accessed at <https://nab.gov.pk/Downloads/330.aspx>, Last accessed on April 21, 2022

⁹⁸ "The Prevention of Corruption Act, 1947", can be accessed at https://ecourt.gov.pk/system/files/THE_PREVENTION_OF_CORRUPTION_ACT_1947.pdf, Last accessed on April 23, 2022

⁹⁹ Ravi Ramamurti, 1987. "Performance Evaluation of State-Owned Enterprises in Theory and Practice," Management Science, JSTOR, Journal Article, INFORMS, vol. 33(7), pages 876 to 893, July, can be accessed at <https://www.jstor.org/stable/2632139>, last accessed on April 23, 2022

3.2.9. Encouraging the Use of Private Sector Practices:

Under OECD guidelines SOEs should adopt private sector practices to improve efficiency and performance. The guidelines recommend promoting competition, encouraging private sector partnerships, and avoiding undue government interference in SOEs operations.

3.3. Relevancy of OECD guidelines with Pakistani Law:

The Organisation for Economic Co-operation and Development (OECD) has developed guidelines for the governance of State-Owned Enterprises (SOEs). While these guidelines are not directly incorporated into Pakistani law, they provide valuable principles and best practices that can inform the compliance efforts of SOEs in Pakistan. Here is an overview of the OECD guidelines and their relevance to Pakistani law:

1. OECD Guidelines on Corporate Governance of State-Owned Enterprises provide recommendations for the governance of SOEs, emphasizing the importance of transparency, accountability, and a level playing field. While Pakistani law does not explicitly adopt these guidelines, the Public Sector Companies (Corporate Governance) Rules, 2013¹⁰⁰ in Pakistan reflect some of the principles outlined in the OECD guidelines, such as the need for independent directors on the boards of SOEs.
2. OECD Guidelines on Transparency and Accountability in the Public Sector promote transparency, integrity, and accountability in the public sector, including SOEs. They highlight the importance of disclosure of information, the prevention of conflicts of interest, and the establishment of effective internal control mechanisms. Pakistani law, including the Companies Act, 2017 and the Public Sector Companies (Corporate Governance) Rules, 2013, incorporates

¹⁰⁰ Public Sector companies (Corporate governance) Rules 2013 can be accessed at <http://www.epf.org.pk/wp-content/uploads/2013/06/public-sector-companies-corporate-governance-rules-2013.pdf>

provisions related to transparency, accountability, and internal control mechanisms.¹⁰¹

3. OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises focus on preventing corruption and promoting integrity in SOEs. They recommend measures such as the establishment of effective anti-corruption policies, the promotion of a culture of integrity, and the enforcement of anti-corruption laws. In Pakistan, anti-corruption measures are governed by laws such as the National Accountability Bureau (NAB) Ordinance, 1999, which investigates corruption cases, including those related to SOEs.¹⁰²
4. OECD Guidelines for Multinational Enterprises cover a broad range of topics related to responsible business conduct, including human rights, labor standards, environmental protection, and bribery. While these guidelines are primarily aimed at multinational enterprises, SOEs in Pakistan that engage in international business activities can use these guidelines as a reference to ensure compliance with international standards.

To cut the long story short, OECD guidelines provide valuable guidance but the specific legal requirements and regulations of Pakistan should be the primary focus for SOEs operating within the country. However, adopting principles and best practices outlined in the OECD guidelines can help SOEs in Pakistan enhance their governance, transparency, and accountability standards, aligning with international norms and standards.

¹⁰¹ Companies Act, 2017 can be accessed at https://nab.gov.pk/uploads/documents/1497361916_101.pdf

¹⁰² National Accountability Bureau (NAB) Ordinance 1999, can be accessed at <https://nab.gov.pk/Downloads/1221199>

3.4. Compatibility of Theories related to Corporate Governance of SOEs with Pakistani Legal Framework:

Various theories related to the Corporate Governance¹⁰³ of SOEs have been developed which ensure and promote transparency, efficiency, and accountability in the operations of SOEs. Some important theories are as follow:

1. Agency Theory
2. Stakeholder Theory
3. Institutional Theory
4. Stewardship Theory

3.4.1. Agency Theory:

Jensen & Meckling defined agency relationship in their book as:

“as an agreement through which one or more persons i-e the principal(s) delegate their authorities to some other persons i-e the agent to act for their sake. For example, the authority to take decisions on behalf of them.”¹⁰⁴

Agency theory discusses this agency relationship in which one person i-e the principal delegates his authorities to another person i-e the agent, who will work on his behalf. Agency theory focuses on the relationship between the principal (shareholders) and the agent (Directors/management) in an organization. In the context of SOEs, the owners are the principal and directors are their agents.¹⁰⁵ It further highlights the potential conflicts of interest between the government (as the ultimate shareholder) and the

¹⁰³ ACCA Article, ‘Corporate Governance from the inside out’ can be accessed at https://www.acaglobal.com/pk/en/student/exam_support_resources/professional_exams_study-resources/strategic-business-leader/technical-articles/corporate-governance-inside-out.html

¹⁰⁴ Michael Jensen and William Meckling, ‘Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure’ (1976) 3(4) Journal of Financial Economics 308

¹⁰⁵ Christine Mallin, Corporate Governance (4th edition, Oxford University Press 2013) page no.16

management appointed to run the enterprise. The theory emphasizes the need for effective governance mechanisms to align the interests of the government with those of other stakeholders and ensure optimal decision-making.

In the context of **Pakistani law**, the Companies Act, 2017, provides a legal framework for addressing agency conflicts in SOEs. It defines the roles and responsibilities of directors, requires disclosure of interests, and mandates shareholder approval for major transactions. These provisions aim to mitigate agency problems by promoting transparency and accountability in SOEs. Companies Act, 2017 suggests:

- The establishment of an Audit Committee.¹⁰⁶
- Composition and functions of the Audit Committee.¹⁰⁷
- Appointment and responsibilities of Board¹⁰⁸ and Directors¹⁰⁹
- Disqualifications for appointment as an independent director.¹¹⁰
- Ineligibility of a person to become director¹¹¹
- Removal of Directors¹¹²
- Duties of directors¹¹³ and Non-executive directors¹¹⁴
- Prohibition on loans to directors.¹¹⁵
- Powers of Board of Directors to issue shares, debenture, borrow loans, invest company's funds and to make loans¹¹⁶
- Duties of the Board of Directors.¹¹⁷

¹⁰⁶ Rule 12 (a) of public sector companies (corporate governance) rules, 2013

¹⁰⁷ Rule 12 (2) of public sector companies (corporate governance) rules, 2013 Ibid, OR Section 178 CA

¹⁰⁸ Rule 5 (1) and (2) of public sector companies (corporate governance) rules, 2013

¹⁰⁹ Companies Act 2017 Sections 154 TO 162

¹¹⁰ Rule 2 (d) public sector companies (corporate governance) rules, 2013 Ibid, Section 199CA

¹¹¹ Companies Act sections 153 and 177 Bank corrupt , Companies ordinance 1984 section 187 and 190 bankcorrupty

¹¹² Section 187 companies act 2017, SECTION 181 OF Companies Ordinance 1984, Public Sector Companies (Corporate Governance) Rules, 2013, Rule 2(d), Rule 3A

¹¹³ Companies Ordinance 184, section 174 to 187 , and Companies Act 2017 182 to 194,

¹¹⁴ Rule 12, clause (2) public sector companies (corporate governance) rules, 2013

¹¹⁵ Section 182 CA, and section 195 companies ordinance

¹¹⁶ Ibid, Section 183Companies Act 2017

¹¹⁷ First Schedule, part TWO, Powers and duties of Board of Directors, companies act 2017

3.4.2. Stakeholder Theory:

Freeman & Reed in their article,¹¹⁸ has defined stakeholders as

“Those groups without whose support the organization would cease to exist”

Freeman and Reed has characterized stakeholders as the persons who can influence or be influenced by the success of the company and its goals. Stakeholder theory recognizes that corporations have responsibilities to a broader set of stakeholders beyond just shareholders. This theory emphasizes the importance of considering the interests of employees, customers, suppliers, and the community in corporate governance practices. In the case of SOEs, stakeholder theory highlights the need to balance the interests of the government, employees, and the general public.

Under **Pakistani law**, SOEs are expected to serve the interests of multiple stakeholders, including the government, employees, and the public. The Public Sector Companies (Corporate Governance) Rules, 2013, require SOEs to establish mechanisms for stakeholder engagement and consider the interests of all stakeholders in their decision-making processes.

These rules also provide guidelines for the corporate governance of public sector companies in Pakistan.¹¹⁹ Some rules are mentioned below:

- Rule 3: Composition and independence of the Board of Directors.¹²⁰
- Rule 3A: Appointment, qualification, and disqualification of directors.¹²¹
- Rule 5: Responsibilities, powers and functions of the Board of Directors.¹²²

¹¹⁸Edward Freeman and David Reed, 'Stockholders and Stakeholder: A New Perspective on Corporate Governance' (1983) 25(2) California Management Review 88, can be accessed at https://www.researchgate.net/publication/233345277_Stockholders_and_Stakeholders_A_New_Perspective_on_Corporate_Governance

¹¹⁹ Public Sector companies (Corporate governance) Rules 2013 can be accessed at <https://www.oft.org.pk/wp-content/uploads/2019/02/public-sector-companies-rules-2013-april-11-2017.pdf>

¹²⁰ Public Sector Companies (Corporate Governance) Rules, 2013, Rule 3

¹²¹ Ibid, Rule 3 and 3A

¹²² Ibid, Rule 5

- Rule 12: Establishment and functions of board committees.¹²³
- Rule 9: Audit Committee and its functions to monitor related party transactions.¹²⁴
- Rule 12(e): Nomination Committee and its function.¹²⁵
- Risk Management Committee and its function.¹²⁶
- Rule 13: Compliance with disclosure requirements.¹²⁷
- Rule 14: Shareholder engagement and communication.¹²⁸

3.4.3. Stewardship Theory:

Stewardship Theory is another theory that can be relevant to the corporate governance of state-owned enterprises (SOEs) in Pakistan. This theory emphasizes the alignment of interests between managers and shareholders. Stewardship theory assumes are intrinsically reliable persons¹²⁹ and they can act as responsible stewards of the organization and make decisions in the best interest of shareholders. Stewardship theory suggests that when managers have a strong sense of ownership and identification with the organization, they are more likely to act in a way that maximizes long-term value for shareholders¹³⁰ hence they should be authorized to independently direct and manage the companies.

In the context of **Pakistani law**, stewardship theory aligns with the principles of accountability, transparency, and fiduciary duty that govern the relationship between managers and shareholders in SOEs. Several provisions and regulations promote stewardship practices in Pakistan:

¹²³ Ibid, Rule 12

¹²⁴ Ibid, Rule 9

¹²⁵ Ibid Rule 12 (e)

¹²⁶ Ibid Rule 12(b)

¹²⁷ Ibid Rule 5, Sub Rule 5, clause b(i), Rule 17, and Rule 18

¹²⁸¹²⁸ Ibid Rule 17, Rule 19 (3)

¹²⁹ Gavin Nicholson and Geoffrey Keil, 'Can Directors Impact Performance? A Case-based Test of

Three Theories of Corporate Governance' (2003) 15(4) Corporate Governance: An International Review 588

¹³⁰ Lex Donaldson and James Davis, 'Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns' (1991) 16(1) Australian Journal of Management 52

1. Companies Act, 2017: The Companies Act, 2017, outlines the duties and responsibilities of directors, including those serving in SOEs. The Act requires directors to act honestly, in good faith, and in the best interest of the company. Directors are expected to exercise due care, skill, and diligence in their decision-making process.
2. Public Sector Companies (Corporate Governance) Rules, 2013: These rules provide guidelines for the corporate governance of public sector companies in Pakistan. The rules emphasize the need for independent directors, transparent reporting, and effective internal controls. These provisions promote the stewardship behavior of directors by fostering accountability, independence, and responsible decision-making.
3. Board Evaluation Mechanisms: In Pakistan, SOEs are encouraged to conduct regular board evaluations to assess the performance and effectiveness of directors. This practice ensures that directors are fulfilling their stewardship responsibilities, including oversight of strategic decisions, risk management, and financial performance.¹³¹

By adhering to stewardship principles, SOEs can enhance their governance practices¹³² in the following ways:

1. Long-Term Value Creation: Stewardship theory encourages directors and managers to focus on long-term value creation for shareholders. In the context of SOEs, this means making strategic decisions that prioritize sustainable growth, profitability, and the overall success of the enterprise. Pakistani law encourages SOEs to adopt sustainable business practices and consider the interests of all stakeholders to ensure long-term value creation.
2. Board Independence: Stewardship theory recognizes the importance of independent directors who can provide objective oversight and

¹³¹ Committees referred above under Rule 12 of Public Sector companies (Corporate governance), Rules 2013, performs the Board Evaluation mechanism

¹³² Caldwell, Cam, Linda A. Hayes, Patricia Bernal, & Ranjan Karri, "Ethical stewardship – implications for leadership and trust." *Journal of business ethics* 78 (2008): 153-164. Can be accessed at https://www.researchgate.net/publication/5149133_Ethical_Stewardship:_Implications_for_Leadership_and_Trust. Doi: 10.1007/s10551-008-9175-6. 22.11.2022, Last accessed on April 23, 2022

challenge management decisions. Pakistani law requires the appointment of independent directors in SOEs to ensure impartiality, safeguard shareholders' interests, and reduce potential conflicts of interest.

3. **Transparent Reporting and Accountability:** Stewardship theory emphasizes transparency in reporting and accountability for actions and decisions. Pakistani law mandates the disclosure of financial information, related-party transactions, and directors' interests to enhance transparency and accountability in SOEs. This enables shareholders and other stakeholders to assess the stewardship of directors and hold them accountable for their actions.
4. **Ethical Conduct and Risk Management:** Stewardship theory promotes ethical conduct and responsible risk management which ultimately make the leadership more effective and efficient. Pakistani law expects directors to act in good faith, exercise due care, and avoid conflicts of interest. Directors are responsible for identifying and managing risks effectively, ensuring compliance with legal and regulatory requirements, and maintaining the reputation of the SOE.

Stewardship theory is contradictory with the argument taken in this thesis that BODs should comprise of more INEDS as compared to Executive directors. This will ultimately make BODs more independent and more effective for the financial performance of company, which will ultimately protect the interests of shareholders.

3.4.4. Institutional Theory:

Institutional theory examines the impact of social, cultural, and legal institutions on organizational behavior and practices. It explores how formal or informal institutions can have an impact on the behavior and practices of an organization. It recognizes that corporate governance practices are influenced by the broader institutional context within which organizations operate. In the case of SOEs, institutional theory emphasizes the role of

legal frameworks, regulatory bodies, and societal norms in shaping corporate governance practices.¹³³

Institutional theory further emphasizes the significance of organizational legitimacy. By conforming to institutional norms, practices SOEs can become legitimate and ensure their survival. By aligning their structure, actions and practices with social expectations these SOEs can gain the trust of key stakeholders, mitigate risks, and operate effectively within their institutional environment.¹³⁴

In Pakistan, the Companies Act, 2017, and the regulatory oversight of the Securities and Exchange Commission of Pakistan (SECP), along with other laws provides the institutional framework for the corporate governance of SOEs. Societal expectations and cultural norms also shape the governance landscape of SOEs. By adhering to these domestic legal requirements SOEs can enhance their legitimacy and foster trust among stakeholders. Non-compliance may result in legal repercussions and penalties, which will further create coercive pressures for the survival of SOEs.

In conclusion, various theories of corporate governance provide valuable insights into the principles and practices applicable to state-owned enterprises (SOEs). The theories discussed, including agency theory, stakeholder theory, resource dependency theory, institutional theory, transaction cost economics, and legal origins theory, highlight different aspects of corporate governance and their relevance to the legal and regulatory landscape in Pakistan.

¹³³ Scott, W. R. (2014). *Institutions and Organizations: Ideas, Interests, and Identities*. Thousand Oaks, CA: SAGE Publications. <https://doi.org/10.1016/j.hris.2014.05.001>

¹³⁴ DiMaggio, P. J., & Powell, W. W. (1983). "The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields." *American Sociological Review*, 48(2), 147-160.

3.5. Legal Framework related to SOEs in Pakistan:

3.5.1. Companies Act, 2017:

The Companies Act provides the legal framework for corporate governance in Pakistan, including for SOEs. It sets out provisions related to the composition and functions of boards of directors, financial reporting, disclosure requirements, and shareholder rights. These provisions aim to ensure transparency, accountability, and effective management within SOEs.¹³⁵

3.5.2. Public Sector Companies (Corporate Governance) Rules, 2013:

These rules specifically address the corporate governance of public sector companies, which includes many SOEs. They outline governance requirements concerning board composition, appointment of independent directors, audit committees, financial reporting, and disclosure. The rules aim to enhance transparency, accountability, and professionalism in SOEs.

3.5.3. State Owned Enterprises Act 2021:

State owned Enterprises Act 2021 is a recent addition to the legal framework of Pakistan related to corporate governance of SOEs.¹³⁶ The Act provides a comprehensive legal framework for the governance, management, and operation of state-owned enterprises in the country. It also aims to improve the transparency, accountability, and performance of SOEs by establishing clear governance structures, promoting private sector participation, and ensuring the effective use of public resources.

The Act requires SOEs to establish an independent and autonomous board of directors, which will be responsible for overseeing the

¹³⁵ Companies Act, 2017 can be accessed at https://nca.gov.pk/uploads/documents/1117861116_105.pdf
¹³⁶ State Owned Enterprises Act, 2021 can be accessed at https://nca.gov.pk/uploads/documents/16180921122_1324.pdf Last accessed at April 23, 2022

management of the enterprise.¹³⁷ The board will be composed of both “independent directors and ex-officio directors” from government and private sector representatives, with the private sector directors being appointed based on their relevant skills, competence, experience, knowledge and expertise.¹³⁸ Additionally, the Act requires SOEs to prepare and publish annual reports, which will provide detailed information about the enterprise's financial performance, operations, and governance during a particular financial year.¹³⁹

However, its effectiveness will depend on the implementation of its provisions and the establishment of independent oversight mechanisms to ensure compliance.

3.5.4. Securities and Exchange Commission of Pakistan (SECP):

Securities and Exchange Commission of Pakistan (SECP) is indeed the regulatory authority established under the SECP Act, 1997.¹⁴⁰ The SECP is responsible for regulating and overseeing the corporate governance practices in the corporate sector such as capital markets, insurance companies, non-banking financial companies, and other related entities in Pakistan. It issues regulations and guidelines to promote good governance in all types of companies, including SOEs. The SECP plays a vital role in enforcing corporate governance standards, ensuring compliance with relevant laws, and monitoring the financial reporting and disclosure requirements of SOEs.¹⁴¹

3.5.5. Code of Corporate Governance, 2012:

The Code of Corporate Governance, issued by the SECP, provides comprehensive guidelines for companies regarding governance structures, board composition, internal controls, risk management, and

¹³⁷ Ibid n(126), Section 17

¹³⁸ Ibid n(126), Section 12

¹³⁹ Ibid n(126), Section 26

¹⁴⁰ SECP Act, 1997 can be accessed at <https://www.secp.gov.pk/document/secp-amendment-act-1997-for-your-information-and-record/?wpdmdl=17801&refresh=64a308944bfc51688406164> , Last accessed on April 23, 2022

¹⁴¹ Visit official website of SECP at <https://www.secp.gov.pk/>

disclosure practices. While not specific to SOEs, many of the principles and recommendations outlined in the code are applicable to state-owned entities.¹⁴²

3.5.6. Federal and Provincial Legislation:

In addition to the above, there may be specific legislation and regulations applicable to certain sectors or industries in which SOEs operate. For instance, in the energy sector, the Oil and Gas Regulatory Authority (OGRA) Ordinance, 2002¹⁴³ and other sector-specific regulations may impose additional governance requirements on SOEs operating in that industry.

3.5.7. Public Procurement Rules, 2004:

SOEs often engage in public procurement activities. The Public Procurement Rules, 2004 establish procedures for procurement, ensuring transparency, competition, and fairness in the procurement processes of SOEs. These rules aim to prevent favoritism, corruption, and mismanagement of resources. The PPRA Ordinance establishes the Public Procurement Regulatory Authority, which regulates public procurement in Pakistan. It provides rules and guidelines for the procurement of goods, services, and works by public sector organizations, including SOEs. The ordinance promotes transparency, competition, and efficiency in the procurement processes of SOEs.¹⁴⁴

3.5.8. State-Owned Enterprises (Governance and operations) Act 2023:

Pakistan has introduced the State-Owned Enterprises Act, 2023 to streamline and improve the governance of SOEs. The act provides a legal framework for the governance, performance, accountability, and transparency of SOEs. It establishes guidelines for board composition,

¹⁴² Code of Corporate Governance, 2012 revised in 2014 can be accessed at

¹⁴³ <https://www.serp.gov.pk/Content/codes-of-corporate-governance-2012-revised-edition-20142wpdmdl=1472271-12-0000-102ab000d041e88400637>

¹⁴⁴ OGRA Ordinance, 2002 can be accessed at <https://www.ogra.org.pk/legislation>

¹⁴⁴ Public Procurement Rules, 2004 can be accessed at <http://www.ppra.org.pk/legislation>

appointment and tenure of directors, financial reporting, and disclosure requirements specific to SOEs.¹⁴⁵

3.5.9. Public Sector Companies (Appointment of Chief Executive) Guidelines, 2015:

These guidelines outline the criteria and procedure for the appointment of chief executives in public sector companies, including SOEs. They provide guidelines for the selection process, qualifications, and experience required for the position of CEO in these entities. The guidelines aim to ensure that qualified and competent individuals lead SOEs.¹⁴⁶

3.5.10. Anti-Corruption Laws:

Various anti-corruption laws such as the National Accountability Ordinance, 1999,¹⁴⁷ and the Prevention of Corruption Act, 1947,¹⁴⁸ aim to combat corruption and ensure good governance in public institutions, including SOEs. These laws establish mechanisms to investigate and prosecute corrupt practices within SOEs and hold individuals accountable for misconduct.

3.5.11. Companies (Appointment of Legal Advisors and Auditors) Rules, 2017:

These rules govern the appointment of legal advisors and auditors by companies, including SOEs. They provide guidelines for the selection process, eligibility criteria, and responsibilities of legal advisors and auditors. Compliance with these rules ensures the engagement of qualified professionals in legal and auditing functions within SOEs.

3.5.12. Competition Law:

The Competition Act, 2010, regulates competition and prevents anti-competitive practices in Pakistan. It prohibits abuse of dominant

¹⁴⁵ State-Owned Enterprises Act 2023, can be accessed at https://www.finance.gov.pk/SOEs_Act_2023.pdf

¹⁴⁶ Public Sector Companies (Appointment of Chief Executive) Guidelines, 2015 can be accessed at <https://www.secp.gov.pk/document/public-sector-companies-chief-executive-appointment-guidelines-2015/2vypdmrdl-1526&ref=sh-64a-8c74-31a51688407524>

¹⁴⁷ NAB Ordinance 1999 can be accessed at <https://nab.org.pk/en/loaded/noc.asp>

¹⁴⁸ Prevention of Corruption Act, 1947 can be accessed at, <https://acc.punjab.gov.pk/en/act/1947/PREVENTION-OF-CORRUPTION-1947-act-1947.pdf>

positions, anti-competitive agreements, and mergers and acquisitions that significantly reduce competition. This legislation ensures a level playing field for SOEs and promotes fair competition in the market.¹⁴⁹

3.5.13. Codes of Corporate Governance for Specific Sectors:

In addition to the general Code of Corporate Governance, sector-specific codes may apply to certain industries in which SOEs operate. For example, the Securities and Exchange Commission of Pakistan (SECP) has issued the Code of Corporate Governance for Non-Banking Finance Companies, Code of Corporate Governance for Modarabas, and Code of Corporate Governance for Insurance Companies. These codes provide industry-specific governance guidelines applicable to relevant SOEs.

3.6. Critical Analysis on Code of Corporate Governance (CCG):

The Code of Corporate Governance (CCG) in Pakistan is a set of guidelines aimed at promoting transparency, accountability, and effective governance practices in corporations. It provides a framework for the governance of both listed and unlisted companies, including state-owned enterprises (SOEs). While the CCG has made significant contributions to improving corporate governance in Pakistan, it also faces certain criticisms and limitations that require critical analysis.

One of the strengths of the CCG is its emphasis on the independence of the board of directors. It requires a balanced composition of the board, including independent directors, which enhances decision-making processes and protects the interests of stakeholders. The CCG also highlights the importance of board committees, such as the audit committee and the nomination and remuneration committee, which contribute to greater accountability and oversight.

However, one of the key criticisms of the CCG is its voluntary nature. Compliance with the code is not mandatory for all companies, particularly unlisted ones. This limits the effectiveness of the code, as many companies

¹⁴⁹Competition Act, 2010 can be accessed at
http://www.pakistan.gov.pk/uploads/uploads/attachment_data/file/130674/06-1-19.pdf

may choose not to adopt its principles, resulting in inconsistent governance practices. To address this, the Securities and Exchange Commission of Pakistan (SECP) has made efforts to encourage broader compliance and provide incentives for companies to voluntarily adopt the CCG.

Another limitation of the CCG is its focus on listed companies, while ignoring the governance challenges faced by unlisted companies and SOEs. The code could benefit from expanding its scope to cover a wider range of entities to ensure consistent governance standards across all sectors. Additionally, the code does not specifically address the unique governance issues faced by SOEs, which require tailored guidelines and regulations to ensure effective oversight and accountability.

Furthermore, the CCG places significant responsibility on the board of directors, but it does not provide clear mechanisms for enforcing accountability. While the code encourages disclosures and transparency, the lack of effective monitoring and enforcement mechanisms limits its impact. Strengthening regulatory oversight and enforcement by the SECP would enhance the effectiveness of the CCG in promoting good governance practices.

In terms of stakeholder engagement, the CCG could benefit from a more inclusive approach. While it recognizes the importance of stakeholder interests, there is room for improvement in promoting greater stakeholder participation in decision-making processes. This would ensure that the diverse perspectives and concerns of stakeholders are adequately represented and considered in corporate governance practices.

In conclusion, the Code of Corporate Governance in Pakistan has played a significant role in improving governance practices in the country. Its emphasis on board independence and committee structures has enhanced transparency and accountability. However, the voluntary nature of the code, limited coverage of unlisted companies and SOEs, weak enforcement mechanisms, and scope for enhancing stakeholder engagement are areas that require further attention and improvement. Addressing these

criticisms and limitations would contribute to a more robust and effective corporate governance framework in Pakistan.

3.7. Recommendations and Improvements:

In order to address the criticisms and limitations of the Code of Corporate Governance (CCG) in Pakistan and enhance its effectiveness, the following recommendations and improvements can be considered:

1. Mandatory Compliance:

Make compliance with the CCG mandatory for all listed companies, regardless of their size or sector. This would ensure consistent governance standards and create a level playing field for all companies. Additionally, consider extending the applicability of the code to unlisted companies, including large privately-held entities, to promote good governance practices across the board.

2. Tailored Guidelines for SOEs:

Develop specific guidelines within the CCG that address the unique governance challenges faced by state-owned enterprises (SOEs). These guidelines should encompass provisions for ensuring transparency, accountability, and independent oversight in SOEs, taking into account their public nature and the need to safeguard public interests.

3. Strengthen Enforcement Mechanisms:

Enhance the regulatory oversight and enforcement capabilities of the Securities and Exchange Commission of Pakistan (SECP) to ensure compliance with the CCG. This can be achieved through increased resources, training, and collaboration with other regulatory bodies. Implement stricter penalties for non-compliance to create a strong deterrent effect.

4. Broaden Stakeholder Engagement:

Encourage greater stakeholder participation in corporate decision-making processes by including provisions in the CCG that promote shareholder rights, stakeholder consultation, and engagement. This can be achieved through mechanisms such as shareholder forums, annual general meetings, and disclosure requirements that ensure the inclusion of diverse stakeholder perspectives.

5. Enhanced Disclosure Requirements:

Strengthen the disclosure requirements in the CCG to ensure greater transparency and accountability. This can include provisions for comprehensive and timely financial reporting, disclosure of related party transactions, board remuneration, and risk management practices. Clear guidelines should be provided on the content and format of disclosures to facilitate meaningful information for stakeholders.

6. Continuous Monitoring and Evaluation:

Establish a mechanism for continuous monitoring and evaluation of the effectiveness of the CCG. Regular assessments can identify areas of improvement and enable necessary updates to the code to reflect evolving governance practices and global standards. This process should involve feedback from stakeholders, including shareholders, industry experts, and governance practitioners.

7. Awareness and Capacity Building:

Conduct awareness programs and capacity-building initiatives to educate directors, executives, and other stakeholders about the principles and benefits of good corporate governance. These programs can include training workshops, seminars, and guidance materials to help companies understand and implement the CCG effectively.

8. International Best Practices:

Continuously benchmark the CCG against international best practices in corporate governance. Learn from the experiences of other jurisdictions and adapt relevant practices to the local context. This will ensure that the CCG remains relevant, up-to-date, and aligned with global governance standards.

By implementing these recommendations and improvements, the CCG can become a more robust and effective framework for promoting good corporate governance practices in Pakistan. It will help enhance transparency, accountability, and stakeholder confidence in the corporate sector, ultimately contributing to the sustainable growth and development of the economy.

CHAPTER 4: LEGITIMACY OF STATE OWNED ENTERPRISES

(SOES) IN PAKISTAN

4.1. Legitimacy of government shareholding:

State-Owned Enterprises (SOEs) play a significant role in many economies, including Pakistan, where the government holds a substantial shareholding in various sectors. The legitimacy of government shareholding in SOEs raises important questions related to accountability, efficiency, and the balance between state intervention and market forces. To understand the legitimacy of government shareholding in SOEs, corporate law in Pakistan provides a comprehensive analysis.

4.1.1. Legal Framework:

In Pakistan, the legal framework governing SOEs includes the The State-Owned Enterprises (SOE) Governance & Operations Act, 2023, Companies Act, 2017, and specific legislation for particular sectors. These laws outline the powers, rights, and obligations of the government as a shareholder in SOEs. SOEs Governance and Operations Act, 2023 recognizes the government's authority to hold shares in companies, subject to compliance with the law.¹⁵⁰ Additionally, sector-specific legislation, such as the Oil and Gas Regulatory Authority Ordinance, 2002,¹⁵¹ and the Pakistan Telecommunication (Re-Organization) Act, 1996,¹⁵² provides provisions for government shareholding in related industries.

4.1.2. Economic Justifications:

The legitimacy of government shareholding in SOEs is often grounded in economic justifications. According to the World Bank, state-owned enterprises (SOEs) are among the largest companies globally and can potentially play a crucial role in promoting economic growth and

¹⁵⁰ State-Owned Enterprises (SOE) Governance & Operations Act, 2023, Section 2 (d) and 4(a), can be accessed at https://www.finance.gov.pk/SOEs_Act_2023.pdf, Last accessed on May 17, 2023

¹⁵¹ Oil and Gas Regulatory Authority Ordinance, 2002
https://na.gov.pk/uploads/documents/62417db44c00c058_11

¹⁵² Pakistan Telecommunication (Re-Organization) Act, 1996, can be accessed at https://na.gov.pk/uploads/documents/11129727963_180.pdf

development.¹⁵³ The government may argue that strategic industries, such as energy, telecommunications, and transportation, require state intervention to ensure national security, stability, and equitable access to essential services.¹⁵⁴ Government shareholding can facilitate long-term planning, infrastructure development, and the management of natural resources. Additionally, it may allow the government to capture economic rents and redistribute them for public welfare.

4.1.3. Accountability and Transparency:

A key challenge in the legitimacy of government shareholding lies in ensuring accountability and transparency. According to the Asian Development Bank (ADB), well-defined governance frameworks, independent and autonomous boards, and strong reporting mechanisms are vital to prevent conflicts of interest, favoritism, and corruption in state-owned enterprises (SOEs) that operate within Pakistan.¹⁵⁵ The government must exercise its shareholder rights responsibly, avoiding undue interference in the day-to-day operations of SOEs. Clear governance structures, independent boards, and robust reporting mechanisms are essential to prevent conflicts of interest, nepotism, and corruption. Provisions of the Companies Act, such as mandatory disclosure requirements and audit committees, help promote transparency and accountability.

4.1.4. Efficiency and Performance:

Efficiency and performance are another crucial aspects of the legitimacy of government shareholding. According to the Asian Development Bank (ADB), state-owned enterprises (SOEs) generally play a significant role in the major infrastructure projects of a country and continue to be a crucial contributor to employment and economic growth in developing nations across Asia. This report further criticize that government's ownership in

¹⁵³ World Bank, "Corporate Governance of State-Owned Enterprises: A Toolkit". Washington, DC: 2014 World Bank., page no. 16 can be accessed at https://documents1.worldbank.org/curated/en/228331468161770049/pdf/0a202b1a-6000-4000-b000-000000000000_governance-of-state-owned-enterprises-toolkit.pdf

¹⁵⁴ Naveed, Shabana, Yaamina Salman, Nasira Jabeen, Muhammad Zafar Iqbal Jadoon, and Sidra Irfan. "Governance & Management of State-Owned Enterprises in Pakistan." Pakistan Economic and Social Review 56, no. 1 (2018): 47–66. See page No. 58, Can be accessed at <https://www.pesr.org/stable/20616732>.

¹⁵⁵ Ibid (80)

SOEs may lead to inefficiencies, bureaucratic interference, and suboptimal decision-making in Asian countries. Therefore it is correct to suggest that the performance of state-owned enterprises (SOEs) has witnessed a decline in comparison to private companies, primarily due to issues such as corruption, mismanagement, and technical incompetence among their staff.

Asian Development Bank in its report recommends that the management of state-owned enterprises (SOEs) must encourage a competitive work environment by recruiting and retaining skilled individuals through competitive remuneration packages and performance-based incentives. Unlike private enterprises, the evaluation of SOEs' performance should consider both their financial profitability and social advantages.¹⁵⁶ To address this, the government of Pakistan should adopt corporate governance practices that ensure a professional and independent board of directors, merit-based appointments, and performance-based incentives. The Companies Act 2017, along with sector-specific regulations mentioned before, provides guidelines for the governance of SOEs, emphasizing the need for transparency, accountability, and effective decision-making processes, which will also make the government shareholding in SOEs more legit.

4.1.5. Public Interest and Social Responsibility:

Government shareholding in SOEs is often justified based on the notion of serving the public interest and fulfilling social responsibilities. OECD holds government officials managing state-owned enterprises (SOEs), accountable and responsible for their actions. They should fulfill their role as '*active & informed owners*' by effectively communicating objectives and expectations that are in complete alignment with the public interest. SOEs are expected to provide essential services, support national development goals, and address issues toward corporate social responsibility. This includes considerations such as job creation, regional development,

¹⁵⁶ ADB Institute. 2017. "Efficient Management of State-Owned Enterprises: Challenges and Opportunities." Asian Development Bank Institute Policy Briefs 4.
<https://www.adb.org/~/media/default/files/publication/2017-01-01/2017-01-01-017-4.pdf>.

environmental sustainability, and affordability of services.¹⁵⁷ Legislative provisions in State Owned Enterprises Act, 2023 recognized public service obligations. Similarly, Public Sector Companies (Corporate Governance) Rules, 2013, require SOEs in Pakistan, to align their operations with public interest objectives by formulating a policy of corporate social responsibility.¹⁵⁸ Directors of SOEs are also responsible to submit a report regarding environmental and corporate social responsibilities.¹⁵⁹

To conclude, the legitimacy of government shareholding in SOEs in Pakistan hinges on striking a balance between state intervention and market dynamics. The legal framework, including the Companies Act 2017, provides provisions to ensure accountability, transparency, and efficiency in government shareholding. Economic justifications, accountability and transparency measures, efficient governance practices, and a focus on public interest and social responsibility contribute to the legitimacy of government shareholding. However, ongoing efforts are needed to enhance corporate governance practices, strengthen regulatory oversight, and promote effective stakeholder engagement to ensure the continued legitimacy of government shareholding in SOEs.

4.2. Corporate Governance Laws related to the structure of Board & Directors in SOEs in Pakistan:

Corporate governance laws in Pakistan including State Owned Enterprises Act, 2021, encompass provisions that govern the effective and independent functioning of the Board of Directors (BOD),¹⁶⁰ Board structure and composition,¹⁶¹ Disqualifications of directors,¹⁶² Audit committee, and Board Nomination Committee¹⁶³ in State-Owned Enterprises (SOEs). Companies Act, 2017, also applies to SOEs incorporated as public limited

¹⁵⁷ OECD (2020), "OECD Business and Finance Outlook 2020: Sustainable and Resilient Finance", OECD Publishing, Paris, can be accessed at <https://doi.org/10.1787/eb61fd29-en>, Last accessed on May 25, 2022

¹⁵⁸ Public Sector Companies (Corporate Governance) Rules, 2013, Rule 5, Subrule 7, clause j

¹⁵⁹ Ibid, Rule 17, Sub rule 4, Clause (d)

¹⁶⁰ State Owned Enterprises Act 2021, Section 17

¹⁶¹ Ibid, Section 12

¹⁶² Ibid, Section 11

¹⁶³ Ibid, Section 10

companies in Pakistan. It includes provisions related to the BOD, board structure, appointment, and removal of directors. It provides provisions regarding the qualifications¹⁶⁴, disqualifications,¹⁶⁵ removal and vacation of office of directors.¹⁶⁶ It sets out criteria for the eligibility and suitability of directors. It further sets out a criteria for the eligibility and suitability of directors with regard to minimum number as follow:

“A public company other than a listed company shall have not less than three directors and listed company shall have not less than seven directors.”¹⁶⁷

4.2.1. Duties of Directors under Companies Act 2017:

The Companies Act 2017 in Pakistan lays out the obligations and roles of directors. Under this Act, directors are required to act honestly, in good faith, and in the best interests of the company. Their personal interests and the interests of other stakeholders must take a backseat to the company's interests. Directors are also obligated to exercise due care, skill, and diligence in performing their duties. This includes making well-informed decisions, adequately assessing risks, and staying updated about the company's affairs. They are expected to avoid conflicts of interest and refrain from using their position for personal gain. Upholding the company's integrity and reputation is a crucial aspect of their role. Directors are responsible for ensuring the company's compliance with relevant laws, regulations, and internal policies. Furthermore, they are encouraged to actively foster a culture of compliance within the organization. A short summary of duties of directors are as follow:

1. **Fiduciary Duty:** Directors are expected to act honestly, in good faith, and in the best interests of the company. This duty requires directors to prioritize the company's interests over their personal interests or the interests of other stakeholders.

¹⁶⁴ Companies Act, 2017, Section 154 to 162

¹⁶⁵ Companies Act, 2017, Section 172 to 185

¹⁶⁶ Ibid, Section 157 to 171

¹⁶⁷ Ibid, Section 154

2. **Duty of Care:** Directors are required to exercise due care, skill, and diligence in carrying out their responsibilities. This duty involves making informed decisions, adequately assessing risks, and staying informed about the company's affairs.
3. **Duty of Loyalty:** Directors are expected to avoid conflicts of interest and not to use their position for personal gain. They must act in a manner that preserves the integrity and reputation of the company.
4. **Compliance with Laws and Regulations:** Directors are responsible for ensuring that the company complies with applicable laws, regulations, and internal policies. They should actively promote a culture of compliance within the organization.¹⁶⁸
5. **Strategic Planning and Decision Making:** Directors play a crucial role in the strategic planning and decision-making processes of the company. They are expected to contribute to the formulation and implementation of the company's strategy, assess risks, and make informed decisions that align with the company's objectives.

4.2.2. Requirements under Public Sector Companies (CG) Rules, 2013:

Public Sector Companies (CG) Rules, 2013, outlines rules regarding SOEs operating in Pakistan. It covers a wide range of topics, such as the structure of the Board of Directors, selection of independent directors, establishment and responsibility of Audit committee, transparency and disclosure of financial information to shareholders and stakeholders. It further require SOEs to establish an effective internal control system to identify, mitigate and reduce risks to ensure compliance with corporate laws and regulations.

Establishment of an audit committee is a mandatory requirement, under which it consist of at least three directors, all of whom shall be non-

¹⁶⁸ Directors and Secretaries Guide by JamaPunji a project of SECP, Islamabad, Accessed June 26, 2023, can be accessed at

<https://www.secp.gov.pk/sites/default/files/2023-06/2023%20Directors%20and%20Secretaries%20Guide.pdf>

executive directors.¹⁶⁹ Composition of the Board of Directors, specifying the minimum number of directors and the requirement for independent directors is another requirement.¹⁷⁰ The Board of Directors should be composed of both executive and non-executive directors, which includes independent directors and representatives of minority interests. They should possess the necessary skills, expertise, knowledge, and experience to ensure the effective and efficient management of SOEs.¹⁷¹

Composition of the Board of Directors is also prescribed by specifying the minimum number of directors and the requirement for independent directors. At least one-third of the total members of the Board must be independent directors. The Public Sector Company is required to provide information about non-executive, executive, and independent directors in its annual report.¹⁷² Rules regarding Separation of Chief Executive and Chairman in SOEs is also prescribed by these regulations.¹⁷³ Last but not the least, mechanisms for the removal of directors, specifying grounds for removal and the procedure to be followed in special circumstances is also provided in these rules.¹⁷⁴

4.2.3. Sector-Specific Laws and Regulations:

Certain sectors, such as banking, telecommunications, and energy, have their own regulatory frameworks that contain provisions related to the BOD, board structure, appointment, and removal of directors in SOEs operating within those sectors. Examples include the following:

- State Bank of Pakistan Act, 1956¹⁷⁵
- Pakistan Telecommunication (Re-Organization) Act, 1996¹⁷⁶

¹⁶⁹ Public Sector Companies (Corporate Governance) Rules, 2013, Rule 12(a)

¹⁷⁰ Ibid, Rule 3

¹⁷¹ Ibid, Rule 3, Sub rule (1)

¹⁷² Ibid, Rule 3, Sub Rule (2)

¹⁷³ Ibid Rule 4, sub rule (1)

¹⁷⁴ Public Sector Companies (Corporate Governance) Rules, 2013, Rule 2(d), Rule 3A

¹⁷⁵ State Bank of Pakistan Act, 1956, can be accessed at

<https://www.sbp.org.pk/act/1956/act.pdf>

- Oil and Gas Regulatory Authority Ordinance, 2002¹⁷⁷
- Pakistan International Airlines Corporation (Conversion) Act, 2016¹⁷⁸

4.3. Separation of ownership and control in State Owned Enterprises (SOEs) in Pakistan:

The issue of separation of ownership and control is indeed a significant concern in State-Owned Enterprises (SOEs) in Pakistan. This refers to a situation where the government, as the owner of these enterprises, has limited control and influence over their operations and decision-making processes. Where the government holds ownership but does not directly control the day-to-day operations. This legal perspective examines the problem of separation of ownership and control in SOEs. In Pakistan, the governance structure and legal framework for SOEs are regulated primarily by the Companies Act, 2017, and its provisions shed light on the challenges associated with the separation of ownership and control in companies. The Companies Act, 2017 of Pakistan does not specifically contain provisions that directly address the separation of ownership and control in State-Owned Enterprises (SOEs). However, the Act provides general provisions related to corporate governance and the role of directors in companies, which indirectly impact the issue of separation of ownership and control in SOEs.

Companies Act, 2017 outlines the composition and functions of the board of directors of a company. Generally, these provisions applies to all companies, including SOEs. The board is responsible for the management, oversight, and strategic decision-making of the company. In the context of SOEs, the composition, powers and independence of the board are critical to ensure effective oversight and control.¹⁷⁹

¹⁷⁶ Pakistan Telecommunication (Re-Organization) Act, 1996 can be accessed at https://na.gov.pk/uploads/documents/1329727263_180.pdf

¹⁷⁷ Oil and Gas Regulatory Authority Ordinance, 2002 can be accessed at https://pakistancode.gov.pk/pdffiles/administrator/34cd31814840d1_6ac4ebc36c+2c55_1329727263_180.pdf

¹⁷⁸ Pakistan International Airlines Corporation (Conversion) Act, 2016, can be accessed at http://103.11.203.132/pia/1329727263_180.pdf

¹⁷⁹ Companies Act, 2017, Section 154 to 185

It further codifies the qualifications,¹⁸⁰ disqualifications,¹⁸¹ prohibitions and removal of directors. It states that a person can be appointed as a director if they are not disqualified under any law. This provision indirectly impacts the appointment of directors in SOEs, as the government, being the majority shareholder, has the authority to appoint directors. However, the Act does not specifically address the issue of independence and expertise of directors in SOEs.¹⁸²

Companies Act, 2017 also specifies the duties and responsibilities of directors. These include acting in good faith, in the best interests of the company, exercising due care, skill, and diligence, and avoiding conflicts of interest. These provisions apply to directors of all companies, including SOEs, and aim to ensure responsible and accountable governance.¹⁸³

Under the Companies Act, 2017, SOEs are required to have a board of directors responsible for overseeing their affairs and ensuring sound corporate governance. However, the government, as the majority shareholder, often appoints directors who may not possess the necessary expertise and independence to effectively monitor the management of the enterprises. This can result in a lack of checks and balances, leading to potential conflicts of interest and ineffective decision-making processes.¹⁸⁴

Furthermore, the Companies Act, 2017, provides provisions for the appointment of chief executive officers (CEOs) in SOEs. In practice, the government tends to appoint CEOs based on political considerations rather than their qualifications and experience in the relevant industries. This political interference can hinder the autonomy and professional management of the SOEs, as CEOs may face pressure to align their

¹⁸⁰ Companies Act, 2017, Section 153

¹⁸¹ Ibid, Section 172 to 185

¹⁸² Ibid, Section 153 and 163

¹⁸³ Sections 166 to 177

¹⁸⁴ Government related issues of state owned enterprises in Pakistan

decisions with the government's interests rather than acting in the best interests of the enterprises.¹⁸⁵

Another issue related to the separation of ownership and control in SOEs in Pakistan is the absence of an effective regulatory framework¹⁸⁶ to hold the management accountable. While the Securities and Exchange Commission of Pakistan (SECP) oversees the corporate sector, its jurisdiction over SOEs is limited. The absence of a specialized regulatory body for SOEs leaves room for mismanagement, corruption, and non-compliance with corporate governance standards.

Autonomy of SOEs, whether HRM autonomy, financial autonomy or policy autonomy, is another issue related to separation of power and control that can be achieved by the separation of positions of the chairman and CEO in SOEs.¹⁸⁷ Listed Companies (Code of Corporate Governance) Regulations, 2017 in Pakistan requires to have separate persons for the positions of the chairman and CEO in order to maintain separation of roles. Therefore, the chairman & CEO in SOEs shall not be the same person.¹⁸⁸ Furthermore, the appointment of board members and the CEO will be contingent upon meeting the criteria established by the Securities and Exchange Commission of Pakistan (SECP) to minimize the political interference and to strengthen the legitimacy of SOEs in Pakistan.¹⁸⁹

Mostly these SOEs suffer from political interference, inefficiency, financial losses, and a lack of innovation due to inadequate oversight and control mechanisms. These challenges have had adverse effects on the performance and financial sustainability of SOEs in Pakistan.

¹⁸⁵ Corporate Governance a minimalist approach in Pakistan by Samza Fatima, 2016, University of Bedfordshire, Page No.125-126, can be accessed at <https://core.ac.uk/reader/77037930>

¹⁸⁶ Ibid

¹⁸⁷ Ibid n (127), Page no. 59 to 60

¹⁸⁸ Securities and Exchange Commission of Pakistan, "Listed companies (code of corporate governance) regulations (2017), Section 9, Can be accessed at https://www.secp.gov.pk/documents/listed-companies-code-of-corporate-governance-regulations-2017/?wpdmdl=3090&file_id=49be766097991637928918, Last accessed on August 12, 2022

¹⁸⁹ Securities and Exchange Commission of Pakistan (SECP). Press Release. Islamabad, can be accessed at <https://secp.gov.pk/wp-content/uploads/2021/08/Press-Release-Listed-companies-approved-by-SEI-2021-08-12.pdf>

4.4. Domestic Law on Disclosure Practice & its compliance with IFRS

Disclosure practices are crucial for ensuring transparency, accountability, and investor confidence in the operations of State-Owned Enterprises (SOEs). The disclosure obligations for public sector companies (PSCs) in Pakistan are set forth by the Companies Act 2017 and the Public Sector Companies (Corporate Governance) Rules, 2013.¹⁹⁰ This legal literature examines the disclosure practices of SOEs in Pakistan, with reference to related provisions of law, International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), and their compatibility and adoption with domestic law.

4.4.1. 1. Domestic Legal literature on Disclosure Practices:

The Companies Act, 2017, applies to SOEs incorporated as public limited companies in Pakistan. It contains provisions related to financial reporting, disclosure of financial statements, and other relevant information. Companies Act, 2017 mandates the preparation and presentation of financial statements in accordance with the requirements of the law. It prescribes specifies elements that must be included in the financial statements, such as balance sheets, profit and loss accounts, and cash flow statements.¹⁹¹ These financial statements must include a review report provided by the chairman, assessing the overall performance of the board and evaluating the effectiveness of the board's role in accomplishing the company's objectives.¹⁹² Companies Act, 2017 also requires directors to disclose their interest in any contract or arrangement with the company. The director is required to declare any direct or indirect interest in a proposed transaction. Relevant provision is reproduces under:

¹⁹⁰ OECD (2020), "Transparency frameworks for state-owned enterprises in Asia", Page No. 17, can be accessed at <https://www.oecd.org/corporate/transparency-frameworks-soes-asia-2020.htm>. Last accessed on May 26, 2022

¹⁹¹ Companies Act, 2017, Section 223

¹⁹² Ibid, Section 192

*“Every director of a company who is in any way, whether directly or indirectly, concerned or interested in any contract or arrangement entered into, or to be entered into, by or on behalf of the company shall disclose the nature of his concern or interest at a meeting of the board. Provided that a director shall be deemed also to be interested or concerned if any of his relatives, is so interested or concerned. Explanation.— For the purpose of this section “director’s relatives” are— the director’s spouse; the director’s children, including the step children; the director’s parents”*¹⁹³

“Related party transactions” of the directors in SOEs should be disclosed because they have the potential to impact the financial position and performance of an entity. Proper disclosure of related party transactions is mandatorily required in Companies act, 2017 to maintain the integrity of financial reporting, promote transparency, prevent any misconduct, and to make sure that shareholders have access to relevant information.¹⁹⁴

Similarly, according to Public Sector Companies (Corporate Governance) Rules, 2013, SOEs are required to maintain a comprehensive record of related party transactions, categorized by parties involved, for each fiscal year. This record should include all transactions conducted with related parties during that specific year, accompanied by relevant documentation and explanations.¹⁹⁵ These rules specifically address corporate governance requirements for public sector companies, including SOEs. It further requires SOEs to prepare and present audited financial statements annually, providing information on financial performance, assets, liabilities, and other relevant disclosures.¹⁹⁶ Companies (Audit of Cost Accounts) Regulations, 1998, mandates the audit of cost accounts of certain companies, including SOEs, and requires the disclosure of cost information in the financial statements.

¹⁹³ Companies Act, 2017, Section 205

¹⁹⁴ Companies Act, 2017, Section 208

¹⁹⁵ Public Sector Companies (Corporate Governance) Rules, 2013, Rule 9

¹⁹⁶ Ibid, Rule 10, 20 & 21

SOEs are also required to adapt and implement the International Financial Reporting Standards (IFRS) as it is.¹⁹⁷ Companies Act also requires SOEs to follow best accounting practices as per International Accounting Standards (IAS) to ensure transparency.

4.4.2. International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS):

International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) are globally recognized accounting standards that aim to achieve consistency, comparability, and transparency in financial reporting. While not directly applicable in Pakistan but compatible with domestic laws, they serve as benchmarks for financial reporting and disclosure practices worldwide. IFRS and several IAS standards are relevant to disclosure requirements. Some relevant standards prescribes:

- Disclosure requirements for financial instruments, including information on their nature, risks, and valuation.¹⁹⁸
- Disclosure of transactions and relationships with related parties that may influence the financial position and performance of an entity.¹⁹⁹
- Disclosure of impairment losses recognized on assets, ensuring transparency in assessing their recoverable values.²⁰⁰
- Disclosure of interest in other entities such as subsidiaries²⁰¹
- Disclosure of Intangible Assets²⁰²; that are without physical substance for instance, goodwill, brand names, patents, research, and development cost²⁰³

¹⁹⁷ Ibid, Rule 16

¹⁹⁸ IFRS 7 "Disclosure of Financial instruments"

¹⁹⁹ IAS 24 "Related party transactions"

²⁰⁰ IAS 36 "Impairment of Assets"

²⁰¹ IFRS 12 "Disclosure of Interest in other entities"

²⁰² IAS 38 "Disclosure of Intangible Assets"

²⁰³ ACCA. Technical Article "Intangible Assets – Can't touch this", London, can be accessed at <https://www.accaglobal.com/glob/en/student/cyber-learning/essentials-of-fundamental-exams-study-resources/17/technical-articles/intangible-assets-1024>

- Disclosure of Goodwill as an intangible asset in the financial statements which represents the future economic benefits arise due to acquisition of other assets in business combinations²⁰⁴

SOEs in Pakistan are encouraged to adopt and comply with IFRS and IAS to ensure transparency and comparability of financial statements. Compliance with these standards improves the quality and reliability of financial information, facilitating informed decision-making by stakeholders. The Institute of Chartered Accountants of Pakistan (ICAP) has developed its own Accounting Standards to harmonize domestic accounting practices with international standards (IFRS & IAS). They provide specific guidelines for financial reporting and disclosure, including requirements for SOEs.²⁰⁵

Securities and Exchange Commission of Pakistan (SECP), as the regulatory authority for companies in Pakistan, monitors and enforces compliance with financial reporting and disclosure requirements. SECP periodically issues regulations, guidelines, and circulars to ensure adherence to reporting standards and enhance transparency. Companies (General Provisions and Forms) Regulations, 2018,²⁰⁶ prescribes the format and content of financial statements to be submitted to the SECP.²⁰⁷

SECP implement these International Financial Reporting Standards (IFRS) on the basis of advice provided by the Institute of Chartered Accountants of Pakistan (ICAP). SECP has also granted some exemptions and deferments from complying with the requirements of IFRS in exceptional cases. By following the guidance from the Institute (ICAP), SECP has adopted all applicable International Financial Reporting Standards (IFRS), with the exception of IFRS1. SECP has deferred applicability of IFRS

²⁰⁴ IFRS 3 “Business Combinations”

²⁰⁵ Visit official website of Institute of Chartered Accountants of Pakistan (ICAP), which provides the IFRS/IAS adoption status as on December 31, 2021, can be accessed at <http://www.icap.net.pk/standards/ifrs-adoption>

206 Companies (General Provisions and Forms) Regulations, 2018, can be accessed at <https://www.secdatabase.com/Document/Company-Information/Forms-and-Filings/2018/2018-cgpdmd1-1422222-sh-649c21704d13> (visited 11/13/2023).

207 Companies Act, Section 512

2 “Shared based payments” requirements for SOEs for the accounting of Benazir Employees Stock Option Scheme (BESOS).²⁰⁸

To conclude, Disclosure practices play a vital role in promoting transparency, accountability, and investor confidence in financial reporting. Pakistan has adopted IFRS and IAS and aligned its domestic law with the disclosure requirements with international standards. Both IFRS and domestic law emphasize the importance of comprehensive financial reporting, including the disclosure of relevant information such as related party transactions, financial instruments, and impairments. However, there may be differences in the level of detail and specific requirements between Pakistani law and IFRS. As the accounting and reporting regulations in Pakistan are primarily based on the IFRS issued by the International Accounting Standards Board (IASB), as communicated through the Companies Act 2017, along with supplementary provisions and directives under the Act. In cases where the provisions and directives of the Companies Act 2017 deviate from the IFRS, the Companies Act 2017 shall prevail. Companies are obligated to carry out audits in alignment with the relevant International Standards on Auditing IAS applicable in Pakistan. So Pakistani law may provide additional or more specific disclosure obligations, tailored to the local context, while IFRS and IAS provide a broader framework for global comparability and transparency.²⁰⁹

4.5. Recommendations related to Disclosure Practices :

Compliance with disclosure practices by SOEs in Pakistan faces several challenges, including a lack of awareness, capacity constraints, and inconsistent enforcement. To address these challenges and improve disclosure practices, the following recommendations can be considered:

²⁰⁸ IPAC, “Adoption & Application of IFRS in Pakistan”, January 2020, Page No.4 and 5, can be accessed at <https://ipac.org.pk/files/Circular-Adoption-and-Application-of-IFRS-in-Pakistan.pdf>

²⁰⁹ OECD (2020), “Transparency frameworks for state-owned enterprises in Asia”, Page No. 24, can be accessed at www.oecd.org/corporate/pdfs/soe-transparency-frameworks-soe-transparency-frameworks.pdf. Last accessed on April 23, 2022

- **Strengthening Regulatory Framework:** Enhance the legal framework by enacting specific regulations or guidelines that address the unique disclosure requirements of SOEs.
- **Capacity Building and Training:** Provide training programs and capacity-building initiatives for SOEs to enhance their understanding of disclosure practices and reporting standards.
- **Independent Auditing and Oversight:** Ensure the appointment of qualified external auditors and establish independent oversight mechanisms to monitor the compliance of SOEs with disclosure requirements.
- **Public Access to Information:** Promote transparency by establishing mechanisms for the public to access relevant information about SOEs, such as financial statements and annual reports.

In short, domestic law provides provisions for financial reporting and disclosure, compliance with international standards such as IFRS and IAS is encouraged. However, challenges exist in achieving full compliance, and improvements are needed in the regulatory framework, capacity building, and oversight mechanisms to enhance disclosure practices of SOEs in Pakistan.

4.6. Anti-trust challenges due to the privileged position of SOEs in Pakistan:

Anti-trust challenges arising from the privileged position of State-Owned Enterprises (SOEs) in Pakistan can have significant implications for competition in the market. This section will discuss these challenges in detail, specifically focusing on the provisions of the Competition Act 2010 and relevant case laws. The Competition Act 2010 is the primary legislation

in Pakistan that addresses anti-competitive practices and promotes fair competition in the market. However, the privileged position of SOEs can create obstacles to fair competition and give rise to anti-trust challenges. Some of the key challenges are²¹⁰:

1. Abuse of Dominant Position:

SOEs, due to their significant market share or government support, may abuse their dominant position to restrict competition. Competition Act, 2010, prohibits anti-competitive agreements and abuse of dominant position.²¹¹ However, the Act also recognizes that certain acts done by SOEs in their capacity as government entities may not be considered anti-competitive.²¹²

2. Unfair Government Subsidies:

SOEs often receive financial support or subsidies from the government, giving them an unfair advantage over private competitors. Such subsidies can distort competition in the market by creating artificial cost advantages for SOEs. Competition Act addresses anti-competitive agreements and practices, including those related to subsidies.²¹³

3. Barriers to Entry:

SOEs in Pakistan, particularly in regulated sectors, have exclusive rights, licenses, or concessions that restrict the entry of new players in the market. This limits competition and hampers innovation and growth. Competition Act deals with the abuse of market power, including creating barriers to entry.²¹⁴ For example, PIA has the sole privilege to operate international flights originating from Pakistan. Similarly, PSO enjoys

²¹⁰ Siddiqui, R. (2014). "State-Owned Enterprises and the Competition Law Regime: A Case Study of Pakistan." *Journal of Competition Law & Economics*, 10(3), 667-691.

²¹¹ Section 3 of Competition Act, 2010

²¹² Visit official website of "Competition Commission of Pakistan" where these challenges are mentioned, can be accessed at <https://cc.gov.pk/home>

²¹³ Section 4 of Competition Act, 2010

²¹⁴ Section 5 of Competition Act, 2010

exclusive rights to import crude oil and petroleum products. PTCL possesses a license to offer fundamental telephony services within Pakistan.

4. Preferential Access to Resources:

SOEs often enjoy preferential access to key resources such as land, capital, and raw materials, which can create barriers to entry for private competitors. This unequal access can hinder competition by limiting the availability of resources for other market players and distorting the level playing field. For example, SOEs have access to preferential and cheaper funding as the government guarantees protection from bankruptcy.²¹⁵

5. Lack of Transparency and Accountability:

SOEs may face challenges in terms of transparency and accountability, as they are often subject to less stringent reporting and disclosure requirements compared to private companies. This lack of transparency can lead to a lack of information about the operations, financials, and decision-making processes of SOEs, making it difficult for private competitors to assess the fairness of competition. The lack of transparency in SOEs can result in a lack of information about their operations, whether financial or non-financial, and can also have adverse impact on the decision-making processes. This can make it difficult for private competitors to assess the fairness of competition.²¹⁶

6. Cross-Subsidization:

SOEs in Pakistan, operating in multiple sectors are engaged in cross-subsidization, where profits from one sector are used to subsidize operations in another sector. This practice can create distortions in the market by

²¹⁵ PWC. "State-Owned Enterprises" PWC Research, Page No. 20 can be accessed at <https://www.pwc.com/gst/en/pwc/publications/assets/pwc-state-owned-enterprises-2019.pdf>

²¹⁶ Fayyaz Yaseen, "Social Accountability in Pakistan: Challenges, Gaps, Opportunities, and the Way Forward", Page No. 5 to 8, First Edition, publication of Sustainable Development Policy Institute, SDPI, May 2013, can be accessed at <https://sdpi.org/-/file/2013/05/SDPI-Files/W-13-1.pdf>, Last accessed on May 27, 2022

allowing SOEs to offer goods or services at below-market prices, making it difficult for private competitors to compete on a level playing field.

During Financial Year 2019, government subsidies for various public sectors including Pakistan Railways in Pakistan were more than Rs. 1 trillion, which included guarantees, foreign and domestic loans, equity investments, and subsidies. However, the dividends received from these investments were only Rs. 60 billion on a much larger asset base of Rs. 16 trillion. The gap between the Ministry of Energy's subsidy demands and the actual allocated amount often results in circular debt as unfunded subsidies, including payments owed by provincial governments to distribution companies (DISCOs).

Therefore, this financial support, bailouts, or guarantees from the government to SOEs, can give them a competitive advantage over private companies. This support can create moral hazard, as SOEs will become risk takers and may take higher risks knowing that the government will step in to support them in case of financial difficulties. This unfair advantage can hinder competition and undermine the viability of private competitors.²¹⁷

7. Lack of Independent Regulation:

SOEs in regulated sectors may face less independent regulatory oversight compared to private companies. This can result in regulatory capture or preferential treatment for SOEs, leading to an uneven regulatory environment that favors the interests of the state-owned entities. Such a situation can impede competition and hinder the development of a level playing field.

Addressing these challenges requires a comprehensive approach that includes strengthening competition laws, ensuring transparency and accountability of SOEs, promoting fair access to resources, and enhancing regulatory oversight. It is essential to establish robust mechanisms for

²¹⁷ Dr. Ishrat Hussain, "The Future of State Owned Enterprises in Pakistan", published on June 7, 2022, can be accessed at <https://dcpak.org/2022/06/07/the-future-of-state-owned-enterprises-in-pakistan/>, Last accessed on May 26, 2022

monitoring and enforcing competition rules and to ensure a level playing field for all market participants. To address these anti-trust challenges, the **Competition Act, 2010** provides for the establishment of the **Competition Commission of Pakistan (CCP)**. The CCP is responsible for enforcing competition laws and promoting competition in the market. It has the authority to investigate anti-competitive practices, impose penalties, and promote competition advocacy.

CHAPTER 5: IMPLEMENTATION AND ENFORCEMENT

MECHANISM OF CG LAWS AND PRINCIPLES RELATED OF

SOES IN PAKISTAN

The implementation and enforcement of corporate governance (CG) laws and principles related to State-Owned Enterprises (SOEs) in Pakistan involve various mechanisms to ensure transparency, accountability, and efficient management of these entities. Some of the key aspects of the implementation and enforcement mechanism in Pakistan include Legal Framework, Board of Directors, Disclosure & transparency requirements, Internal control & Risk management, Compliance Monitoring & Reporting, and Independent Audit.

5.1. Theoretical Legal Framework related to Implementation mechanism of CG laws of SOEs in Pakistan

Companies Act, 2017, is the primary legislation governing corporate governance practices in Pakistan. It sets out provisions and guidelines for SOEs, including the duties of directors and officers,²¹⁸ related party transactions,²¹⁹ shareholder rights,²²⁰ financial statement preparations,²²¹ and financial reporting requirements as per IFRS issued by IASB.²²²

SOEs in Pakistan are required to establish a board of directors responsible for strategic decision-making and oversight. The board composition should include independent directors to ensure impartiality.²²³ The Securities and Exchange Commission of Pakistan (SECP) provides guidelines on board structure, roles, and responsibilities.²²⁴ The SECP's CCG, 2012 which was revised in 2017 and 2019, prescribes that the Board of Directors should be composed of a majority of non-executive directors

²¹⁸ Section 204, Companies Act , 2017

²¹⁹ Ibid, Section 208

²²⁰ Ibid, Section 59

²²¹ Ibid, Section 223 to 245

²²² Ibid, Section 225

²²³ State Owned Enterprises Act 2021, Section 12

²²⁴ SECP's Code of Corporate governance 2019

also including independent directors²²⁵ while possessing competence, skills, expertise and experience relevant to the industry and SOEs sector.²²⁶

In Pakistan, SOEs are also mandated to disclose relevant information to the public, shareholders, and stakeholders. SECP's CCG, further suggests SOEs to include financial statements, annual reports endorsed by Chief Financial Officer & CEO,²²⁷ and disclosures related to related-party transactions that are prepared in accordance with the relevant accounting standards reviewed by Audit Committee, which will provide true and fair position of the SOEs to its stakeholders.²²⁸ Like all other companies SOEs are required to publish annual reports showing compliance statement as well that provides detailed information of its performance, activities, forecasts and prospects.²²⁹ SECP oversees the compliance of SOEs with disclosure requirements.

SOEs are also expected to establish internal control systems and risk management frameworks to identify, assess, and mitigate risks. This risk management framework needs to be aligned with the objectives of SOEs and should provide guidance on risk appetite, risk tolerance, and risk mitigation strategies.²³⁰ The internal audit function should operate independently and report directly to the board to detect and prevent fraud and is a mandatory requirement in the Audit Committee.²³¹ The Audit and Internal Control Guidelines issued by the Auditor General of Pakistan also provide guidance in this regard.²³²

SECP monitors the compliance of SOEs with CG laws and principles. SOEs need to comply with laws, rules, regulations, and CG practices by

²²⁵ Ibid, Section 6

²²⁶ Ibid Section 4

²²⁷ Ibid, Section 2 (b) and Section 25

²²⁸ Ibid, Section 15

²²⁹ Ibid, Section 36

²³⁰ Ibid, Section 10 (2)

²³¹ Ibid, Section 23 and 27

²³² Auditor General of Pakistan, "Audit Guidelines Post Telecommunication and Telegraphy Audit by Auditor-General of Pakistan" can be accessed at <http://agp.gov.pk/SpecPage/111211211.htm>

adhering to accounting standards, disclosure requirements.²³³ SOEs are required to submit periodic reports,²³⁴ including financial statements and compliance reports.²³⁵ Non-compliance should lead to penalties or regulatory action but not codified in Code of Corporate Governance.

SOEs are required to conduct independent audits of their financial statements by certified external auditors registered by Institute of Chartered Accountants of Pakistan (ICAP).²³⁶ Model Audit Practice Manual revised by ICAP is also helpful in this regard.²³⁷ The auditors are expected to express an opinion in the form of audit regarding the fairness of the financial statements in accordance with relevant accounting standards and auditing principles.²³⁸

5.2. Reasons of weak enforcement mechanism of Corporate Governance principles in Pakistan:

One of the main reasons of weak enforcement mechanism and inappropriate compliance with CG principles is the lack of interest of government and lack of awareness & education among stakeholders about CG principles and practices. This results in a limited understanding of the importance of CG and its impact on corporate performance and accountability.²³⁹

The regulatory framework for CG in Pakistan may lack specificity, leaving room for interpretation and potential loopholes. This ambiguity hampers effective enforcement efforts. For example, the absence of clear guidelines on related-party transactions can lead to abuses and non-compliance. Government wants PICG to formulate a separate code of governance

²³³ SECP CCG, Section 34 and 35

²³⁴ Ibid, Section 14 (vi) to (xx)

²³⁵ Ibid, Sections 2 (b), 6(1), 8 (2), 27(4) and **Section 36**

²³⁶ Ibid, Section 23

²³⁷ Model Audit Practice Manual revised by Institute of Chartered Accountants of Pakistan (ICAP) in 2012, <https://icap.org.pk/files/doc/publications/AuditPracticeManualClean.pdf>

²³⁸ SECP CCG, Section 32 (7)

²³⁹ Corporate Governance a minimalist approach in Pakistan by Samza Fatima, 2016, University of Bedfordshire, Page No.125-126, can be accessed at <https://core.ac.uk/reader/pdf/2589>

particularly for state owned enterprises (SOEs).²⁴⁰ A relevant case is the Securities and Exchange Commission of Pakistan (SECP) v. ICL Limited, where the court highlighted the need for a more comprehensive regulatory framework to address CG issues, particularly related-party transactions.²⁴¹

Regulatory bodies responsible for enforcing CG laws often face resource constraints, including a lack of staff and expertise. The limited resources and capacity can result in inadequate monitoring and enforcement. For example, in Government hospital, due to lack of resources (Advanced machinery and apparatus), dozens of patients die every year.²⁴²

Political interference and Weak regulatory oversight can contribute to the weak enforcement of CG. Political interference, bureaucratic hurdles, and ineffective governance structures within regulatory institutions can hinder robust oversight and enforcement.²⁴³ In the case of Securities and Exchange Commission of Pakistan (SECP) v. Azgard Nine Limited, the court highlighted the need for stronger regulatory oversight to address CG violations.²⁴⁴

Major corporate scandals in SOEs mentioned in the introduction chapter, categorically proves the malifide on the part of government. Unsuccessful implementation of CG laws is due to non-serious role of the government. Government needs to introduce new reforms by taking strong legislative measures to support corporate sectors, especially SOEs sector. Political instability also contributes in the weak enforcement mechanism or implementation of CG laws, as the governments won't be able to update laws or take long term decisions due to their short tenures.²⁴⁵

²⁴⁰ Ibid n (26) Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan, by Faryal Salman and Kamran Siddique based on the interview (held on October 21, 2011) with Etrat Hussain Rizvi, Former Commissioner, Securities and Exchange Commission of Pakistan (SECP).

²⁴¹ 2012 CLD 2322 (SECP)

²⁴² Ibid (n 78) Page no.127

²⁴³ Ibid

²⁴⁴ 2014 CLD 2732 SECP

²⁴⁵ Ibid (n 82)

Inadequate penalties and sanctions for Corporate Governance violations undermine the effectiveness of enforcement efforts. Weak deterrents fail to discourage non-compliance, enabling violators to escape meaningful consequences. So inadequate penalties and sanctions for breaches in corporate governance is another reason for the weak enforcement mechanism which adversely affect the governance of SOEs. Furthermore, these should be codified in the law as well."²⁴⁶

Ineffective reporting and disclosure mechanisms for Corporate Governance related information hamper the detection and investigation of CG breaches. Insufficient reporting requirements and a lack of transparency further contribute to weak enforcement.²⁴⁷

The judicial system in Pakistan faces challenges such as delays and a backlog of cases. Lengthy litigation processes can undermine the timely resolution of CG-related disputes, leading to a perception of weak enforcement.²⁴⁸ A relevant case is the Lahore High Court judgment in the case of SECP v. Shoaib Ahmad Sheikh, where the court emphasized the need for expeditious disposal of CG-related cases to ensure effective enforcement.²⁴⁹ Judicial officers may have limited expertise in CG matters, resulting in inconsistent rulings and interpretations. This limits the effectiveness of the enforcement mechanism.²⁵⁰

Limited shareholder activism and engagement in Pakistan weaken the demand for and enforcement of good CG practices. Active shareholder

²⁴⁶ Corporate Governance a minimalist approach in Pakistan by Samza Fatima, 2016, University of Bedfordshire, Page No. 134, can be accessed at <https://core.ac.uk/reader/77037980>

²⁴⁷ Ibid (n 85) Page No. 130

²⁴⁸ Ibid

²⁴⁹ 2020 CLD 424 Lahore High Court

²⁵⁰ Corporate Governance Structure and performance of Malaysian Listed Companies, by Roszaini Haniffa & Mohammad Hudaib, published in 2006, Journal of Business, Finance and Accounting, Page No. 1034-1062 can be accessed at <https://eprints.beds.ac.uk/doi/pdf/10.1111/j.1468-2299.2006.00594.x>

participation is crucial for ensuring effective CG mechanisms.²⁵¹ Cultural norms and ethical considerations can impact the enforcement of CG in Pakistan. Practices such as nepotism, favoritism, and corruption undermine the integrity and effectiveness of CG mechanisms.²⁵²

5.3. Corporate Judicature in Pakistan:

Corporate judicature in Pakistan refers to the judicial system and legal framework that governs corporate matters, including disputes and legal proceedings related to corporate governance. Both the constitution of Pakistan 1973 and SECP Act 1997, provides the corporate Judicature of Pakistan that plays a crucial role in upholding the principles of transparency, accountability, and fairness in corporate practices.

In Pakistan, corporate matters are primarily dealt with by civil courts and specialized tribunals. The civil courts, including the Supreme Court and the High Courts, have jurisdiction over corporate disputes and provide a forum for resolving conflicts arising from corporate governance issues. These courts interpret and apply the relevant laws, regulations, and principles to ensure effective corporate governance.²⁵³

Additionally, Pakistan has established specialized tribunals to deal with specific corporate matters and complaints,²⁵⁴ such as the Securities and Exchange Commission of Pakistan (SECP) Tribunal and the Intellectual Property Tribunal. These tribunals focus on resolving disputes and

²⁵¹ Sattar Kan, Yasir Kamal, Shahid Hussain & Muhammad Abbas, "Corporate Governance looking back to look forward in Pakistan: a review, synthesis, and future research agenda", published in *Future Business Journal*, article 8 of 22 (2022), can be accessed at <https://doi.org/10.1136/s43093-022-00137-5>

²⁵² Ibid (n 85)

²⁵³ Corporate Governance- Issues and Challenges in Pakistan, by Beenish Ameer, Department of Management and sciences, Abbasia Campus, Islamia University of Bahawalpur, published in *International Journal of Academic Research in Business and Social Sciences*.(2012) Page No. 88 can be accessed at https://human3.com/papers_uploaded/0521/corporate-governance-issues-and-challenges-in-pakistan.pdf

²⁵⁴ Corporate Governance a minimalist approach in Pakistan by Samza Fatima, 2016, University of Bedfordshire, Page No. 138, can be accessed at <https://www.researchgate.net/publication/317703780>

adjudicating cases related to securities laws, company law violations, and intellectual property rights, among others. The establishment of specialized tribunals aims to ensure expertise and efficiency in dealing with corporate disputes. SECP may establish Appellate Benches with the authority to handle appeals within the organization.²⁵⁵ If a decision is made by a single commissioner, the right of appeal lies with an Appellate Bench composed of multiple commissioners, excluding those who made the initial decision. Any appeal against the Appellate Bench's order must be made to the courts as per Part II of the Ordinance, within a 60-day timeframe.²⁵⁶

The corporate judicature in Pakistan is guided by various laws and regulations that provide the legal framework for corporate governance. The Companies Act, 2017, is the principal legislation governing corporate entities in Pakistan. It sets out the rights and responsibilities of directors, shareholders, and other stakeholders, and provides a legal framework for corporate governance practices. The Companies Act, 2017, also establishes the regulatory authority, the SECP, which plays a vital role in overseeing corporate governance matters.²⁵⁷

Furthermore, the corporate judicature in Pakistan takes into account the principles of equity, fairness, and justice while adjudicating corporate disputes. The judiciary ensures that corporate governance practices adhere to legal requirements and ethical standards, thus promoting transparency and accountability. The courts interpret and apply the relevant laws and regulations in a manner that upholds the interests of all stakeholders, including shareholders, employees, and the public.

The corporate judicature in Pakistan has also played a significant role in shaping and clarifying the legal framework for corporate governance through its judgments and precedents. Judicial decisions have provided guidance on matters such as director's duties, shareholder rights, related-party

²⁵⁵ SECP Act 1997, Section 33 (2)

²⁵⁶ SECP Act 1997, Section 33 and 34

²⁵⁷ Companies Act, 2017, Section 3 i-e Establishment of the Commission

transactions, and disclosure requirements, among others. These judgments contribute to the development of a robust corporate governance regime and serve as a reference for future cases.²⁵⁸

In addition, the Constitution further provides a mechanism for the removal of judges from the superior courts. This mechanism involves the establishment of the Supreme Judicial Council (SJC), which consists of senior judges from the Supreme Court and the High Courts, which has the authority to dismiss a judge in cases of misbehavior, misconduct, or physical or mental incapacity, on the basis of reference made by the President or on its own. Consequently, it is crucial to maintain the independence of judiciary.²⁵⁹

5.4. Judicial problems in Pakistan:

Corporate judicature in Pakistan faces challenges problems such as judicial delays, backlog of cases, and limited judicial expertise in corporate matters. Efforts are being made to address these challenges through judicial reforms, including the establishment of specialized commercial courts and the promotion of alternative dispute resolution mechanisms. These reforms aim to enhance the efficiency and effectiveness of the corporate judicature in resolving corporate governance disputes in a timely and fair manner. Judicial Reforms (Amendment) Act, 2019 has addressed such issues. Following are some prevailing problems of corporate judicature in Pakistan.²⁶⁰

The judicial system in Pakistan faces challenges related to delays in the disposal of cases and a significant backlog of pending cases. These delays can hamper the timely resolution of corporate governance disputes and impact the effectiveness of the judicial process.

²⁵⁸ Ibid n(249)

²⁵⁹ Article 209 of the Constitution of Islamic Republic of Pakistan.

²⁶⁰ Corporate Governance a minimalist approach in Pakistan by Samza Fatima, 2016, University of Bedfordshire , Page No. 141 - 147, can be accessed at <https://core.ac.uk/reader/77037720>

The Constitution of Pakistan, 1973 outlines detailed guidelines regarding the composition, jurisdiction, powers, and functions of the courts. The Constitution entrusts the superior courts with the responsibility to protect and preserve the Constitution.²⁶¹ It also lays out procedures for the appointment, qualification, and remuneration of judges.²⁶² Despite the constitution emphasizes the need for the separation of the judiciary from the executive and its autonomy,²⁶³ the judiciary in Pakistan still has not been completely independent from the influence of the executive branch. The Supreme Court and High Courts have been granted the power to control their finances independently, which is essential to safeguard the judiciary's independence and prevent any Executive interference in financial matters.²⁶⁴ But still political interference has been a significant factor preventing the establishment of a strong and independent judiciary in the country.

The complex nature of corporate disputes requires specialized knowledge and understanding of corporate laws and practices, which can sometimes be lacking among judges. This can lead to inconsistent rulings and interpretations. The absence of dedicated courts for handling corporate and commercial is a significant challenge which can only be possible by making amendments in the law (Companies Act 2017).

Corporate governance disputes often involve technical and specialized aspects, such as accounting practices, financial analysis, and interpretation of Company law provisions. The technical complexity of these matters can pose challenges for the judiciary in properly understanding and adjudicating such disputes. Judicial officers may face challenges in keeping up with evolving corporate governance laws and practices due to a lack of regular training and continuing education programs. The dynamic nature of

²⁶¹ The Constitution of Pakistan, 1973, Article 178, 194 read with the third schedule

²⁶² Ibid, Article 18 -21

²⁶³ The Constitution of Pakistan, 1973, Article 2(A), 174, clause 3, read with & Preamble

²⁶⁴ "Government of Sindh vs. Sharaf Faridi" PLD 1994 Supreme Court 10

corporate governance requires judges to stay updated with the latest developments and trends to effectively handle corporate disputes.

The limited use of alternative dispute resolution mechanisms, such as mediation and arbitration, in resolving corporate governance disputes is a challenge. ADR methods can offer faster and more cost-effective resolutions, but their adoption and promotion within the judicial system need further emphasis.

Inconsistency in judgments related to corporate governance matters can create uncertainty and confusion. Different interpretations of laws and principles by different judges or courts can lead to inconsistent precedents, making it challenging for stakeholders to understand their rights and obligations.

The availability of effective legal remedies is crucial for ensuring the enforcement of corporate governance principles. However, the limited range of legal remedies and penalties for corporate governance violations may undermine the deterrent effect and weaken the overall enforcement mechanism.

The high cost of litigation can act as a barrier for individuals and smaller entities to pursue corporate governance disputes. Legal expenses, including court fees and attorney fees, can be substantial, making it difficult for stakeholders with limited resources to seek redress in the judicial system.

Even when judgments are rendered in favor of stakeholders in corporate governance disputes, the challenge lies in the effective enforcement of those judgments. Non-compliance with court orders and delays in implementing judgments can undermine the effectiveness of the judicial process.

5.5. The Judicial REFORMS in Pakistan

Some of the judicial reforms that can be implemented to address the problems in the corporate judicature of Pakistan:

1. Implementing effective case management systems, such as specialized corporate and commercial courts, can help expedite the resolution of corporate governance disputes. Timely disposal of cases will reduce delays and ensure efficient justice delivery.²⁶⁵
2. Providing specialized training programs for judges on corporate governance laws and practices will enhance their understanding and expertise in handling corporate disputes. Regular continuing education programs will help judges stay updated with the evolving corporate governance landscape.
3. Establishing dedicated courts for corporate matters with specialized judges which can ensure the efficient handling of complex corporate governance matters that can only be possible through amendments in the existing laws. These courts should have the necessary expertise and experience in corporate law to deliver consistent and informed judgments.²⁶⁶
4. Encouraging the use of alternative dispute resolution mechanisms, such as mediation and arbitration, can provide faster and cost-effective resolutions for corporate governance disputes. Promoting ADR methods through awareness campaigns and legal reforms will reduce the burden on the judicial system.

²⁶⁵ Shah, S. Z. A., & Shah, S. M. A. (2019). Efficiency and Quality of Justice Delivery in Pakistan: An Analysis. *Journal of Law and Social Sciences*, 1(1), 1-13.

²⁶⁶ Ibid

5. Providing specialized training to judges on technical aspects of corporate governance, such as accounting practices and financial analysis, will equip them with the necessary knowledge to effectively understand and adjudicate complex corporate disputes.
6. Encouraging the development of precedents and promoting consistency in judicial decisions related to corporate governance will provide clarity and guidance to stakeholders. Regular case law review and consultations among judges can help establish uniform interpretations of corporate governance laws.
7. Reviewing and revising the legal framework to ensure the availability of adequate legal remedies and penalties for corporate governance violations will enhance the effectiveness of the judicial process. Strict enforcement of penalties will act as a deterrent against non-compliance.²⁶⁷
8. Investing in modern court infrastructure and leveraging technology, such as e-filing systems and digital case management tools, will streamline court proceedings and enhance the efficiency of the judicial system. This includes improving access to legal resources and facilitating online filing of cases.²⁶⁸
9. Strengthening mechanisms for the enforcement of court judgments, including penalties for non-compliance, will ensure the effective implementation of judicial decisions. Regular monitoring and evaluation of the implementation process will help address any delays or obstacles.²⁶⁹

²⁶⁷ Ahmad, A. (2019). Corporate Governance in Pakistan: Legal Framework, Challenges, and the Way Forward. *Pakistan Journal of Legal Studies*, 1(1), 1-24.

²⁶⁸ Shah, S. Z. A., & Shah, S. M. A. (2019). Efficiency and Quality of Justice Delivery in Pakistan: An Analysis. *Journal of Law and Social Sciences*, 1(1), 1-13.

²⁶⁹ Ibid

10. Upholding the principles of judicial independence and accountability is crucial for the effective functioning of the judicial system. Ensuring the appointment of competent and impartial judges and establishing effective mechanisms for judicial accountability will enhance the credibility and integrity of the judiciary.²⁷⁰

²⁷⁰ Ahmad, A. (2019). Corporate Governance in Pakistan: Legal Framework, Challenges, and the Way Forward. *Pakistan Journal of Legal Studies*, 1(1), 1-24.

CHAPTER 6: CONCLUSION AND SUGGESTIONS

6.1. Conclusion:

In conclusion, while SOEs in Pakistan face numerous challenges and issues, addressing them through a comprehensive approach that encompasses legal reforms, enhanced governance practices, improved disclosure mechanisms, strengthened enforcement mechanisms, and capacity building can pave the way for a more robust and effective SOE sector. By implementing the suggested solutions and recommendations, Pakistan can establish a conducive environment for the growth and success of its state-owned enterprises, ultimately benefiting the economy and the well-being of its citizens.

The analysis of the legal issues and challenges surrounding SOEs in Pakistan highlights the need for comprehensive reforms and effective implementation of corporate governance mechanisms. The conclusion draws on the findings from the preceding discussions, which covered various aspects such as the legitimacy of government shareholding, structural legitimacy, separation of ownership and control, disclosure practices, antitrust challenges, and the implementation and enforcement of corporate governance laws. Through this analysis, several key recommendations emerge to address these challenges and promote good governance practices in SOEs.

The legitimacy of government shareholding in SOEs is a critical issue that requires careful consideration. While the government's role in these entities is important for economic development and public welfare, it is crucial to ensure transparency, accountability, and adherence to the principles of corporate governance. The relevant provisions of Pakistani law, including the Companies Act and SOE-specific regulations, need to be

strengthened to address concerns related to conflicts of interest and political interference. For instance, the Companies Act 2017 can be amended to include provisions that require the government to exercise its shareholding rights in a manner that promotes the best interests of the company and its stakeholders. Additionally, regulations specific to SOEs can be introduced to establish clear guidelines for the governance of these entities, ensuring that their decision-making processes are transparent and aligned with the principles of corporate governance. By enhancing the legal framework, Pakistan can strike a balance between government control and the autonomy of SOEs.

The structural legitimacy of SOEs in Pakistan is another important area that requires attention. Clear board structures, effective appointment and removal processes for directors, and the establishment of independent and competent boards are crucial for ensuring good governance. The Companies Act and other corporate governance regulations should be revised to promote greater transparency, accountability, and professionalism in the boards of SOEs. For example, the Companies Act can include provisions that require SOEs to have a certain percentage of independent directors on their boards. This would help minimize conflicts of interest and enhance the independence of board decisions. Additionally, guidelines can be developed to specify the qualifications and criteria for board appointments, ensuring that directors possess the necessary skills and expertise to effectively fulfill their roles. Regular performance evaluations of board members can also be mandated to ensure accountability and maintain the integrity of the governance structure.

The problem of separation of ownership and control in SOEs poses challenges to effective governance. Pakistani law should incorporate mechanisms that align the interests of shareholders and management, enhance disclosure requirements, and establish checks and balances to minimize the risks associated with the separation of ownership and control. One of the possible solutions is to introduce stricter regulations regarding

related-party transactions. This would require SOEs to disclose and seek approval for transactions involving related parties, ensuring transparency and minimizing potential conflicts of interest. Additionally, the Companies Act can be amended to include provisions that empower shareholders to hold management accountable through increased disclosure and voting rights. Such measures would help bridge the gap between ownership and control, promoting responsible and accountable management practices.

In the context of disclosure practices, it is essential for SOEs in Pakistan to meet international standards, such as the International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS). Compliance with these standards enhances transparency and improves the reliability of financial reporting. The Pakistani law, including the Companies Act and the Code of Corporate Governance, should be amended to align with these international standards.

Specific provisions within the Companies Act 2017 can be revised to incorporate the reporting requirements of IFRS and IAS. Additionally, the regulatory authorities responsible for overseeing financial reporting, such as the Securities and Exchange Commission of Pakistan (SECP), should issue guidelines and provide training to ensure that SOEs understand and implement the necessary accounting and disclosure practices. Compliance with international standards will enhance the credibility of financial statements and promote investor confidence in SOEs.

The privileged position of SOEs can present antitrust challenges and hinder fair competition in the market. The Competition Act 2010 provides a legal framework to address such challenges, and its effective enforcement is crucial. The Competition Commission of Pakistan (CCP) should actively monitor and investigate anti-competitive practices, particularly those involving SOEs. To strengthen the enforcement of antitrust laws, the CCP can enhance its capacity by recruiting skilled personnel and investing in training programs. It should also establish mechanisms for collaboration

with other regulatory bodies, such as the SECP, to exchange information and coordinate efforts in addressing antitrust issues related to SOEs. Case laws, such as the Pakistan State Oil case, highlight the role of the judiciary in addressing antitrust issues and promoting fair market competition. These cases serve as precedents and provide guidance for future legal decisions.

The aftermath of all above discussion is that the issues and challenges faced by SOEs in Pakistan require a multi-faceted approach encompassing legal reforms, effective implementation of corporate governance mechanisms, and strong judicial interventions. The recommendations outlined above, supported by relevant provisions of Pakistani law and case laws, aim to strengthen corporate governance practices, enhance transparency and accountability, and promote a fair and competitive business environment. By addressing these challenges, Pakistan can foster the sustainable growth and development of its State-Owned Enterprises, contributing to the overall economic progress of the country.

6.2. Recommendations:

In light of the above, several recommendations can be made to address the issues and challenges facing SOEs in Pakistan. These recommendations include:

1. Periodic review and revision of the legal framework governing SOEs to ensure alignment with international best practices and changing circumstances.
2. Legislating laws specific to State-Owned Enterprises (SOEs), either through the creation of new legislation or by amending existing laws, to address the distinct characteristics and challenges encountered by these entities.
3. Strengthening board structures, ensuring independence and expertise among directors, and implementing transparent processes for their appointment and removal.
4. Enhancing disclosure practices, including financial reporting, material transaction disclosure, and adherence to international accounting standards.
5. Promoting shareholder rights and engagement through clear and accessible channels of communication.
6. Strengthening the enforcement mechanism through enhanced regulatory oversight, independent auditing, and strict penalties and sanctions for non-compliance.
7. Fostering capacity building and training programs to enhance the skills and knowledge of directors, management, and employees in SOEs.
8. Encouraging collaboration and knowledge sharing among SOEs through industry conferences, seminars, and forums.

By implementing these recommendations, SOEs in Pakistan can overcome their challenges and transform into efficient, transparent, and accountable entities that contribute significantly to the country's economic growth and development.

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