



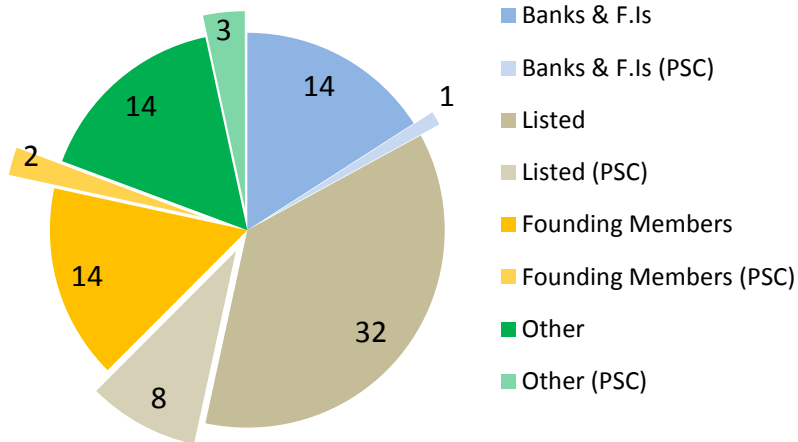
Lessons from SOE Governance Reforms

Pakistan Case Study

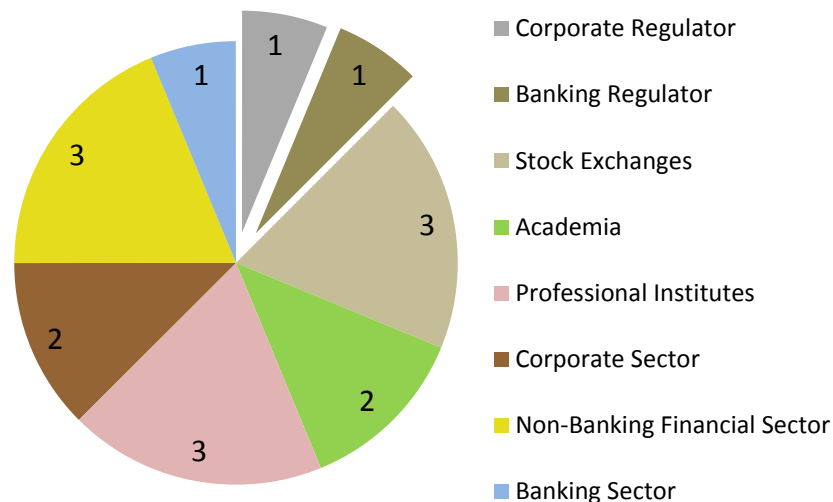
Fuad Azim Hashimi – Ankara, June 10, 2014

PICG – A Snapshot Of Engagement

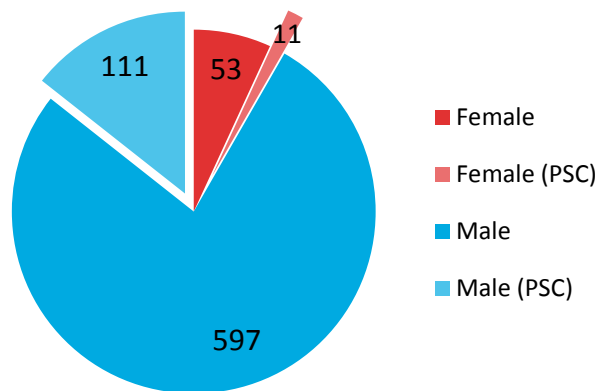
Corporate Membership (88)



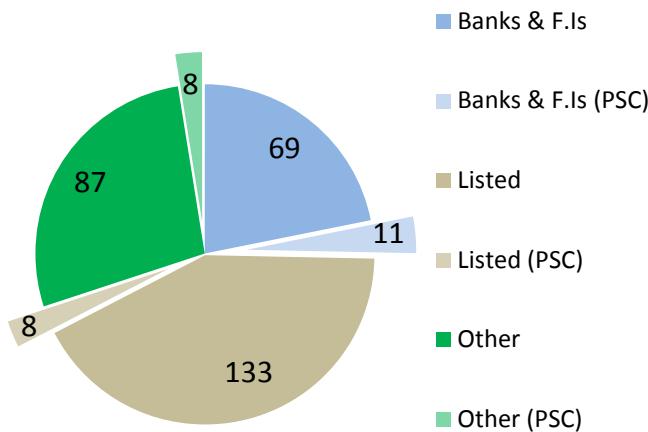
Founding Members (16)



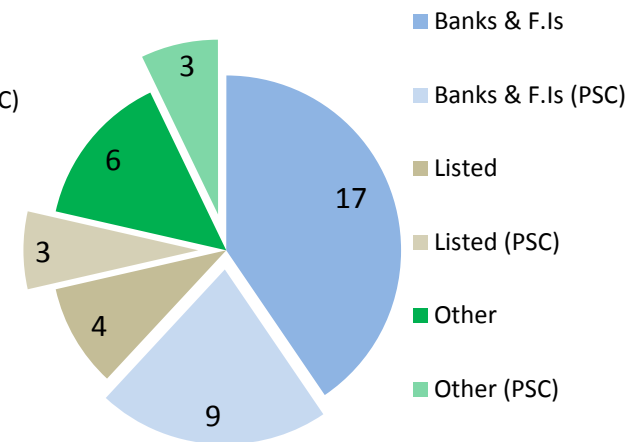
Director Education Program - Participants Engaged (177 Sessions, 772 Participants)*



Director Education Program - Companies Engaged (177 Sessions, 316 Companies)*



Directors Orientation Workshop – Companies Engaged (55 Sessions, 42 Companies)



***2007 till date - 512 participants (84 from PSCs) have attained Certificate of Director Education of which 185 are from the membership**

SOE DIMENSIONS IN PAKISTAN

- Total 190 SOEs:
 - 140 involved in commercial activities
 - 50 involved in strategic sectors like power, transport & financial
- Of the above:
 - 80 are identified for privatization
 - 16 are listed companies representing nearly 1/3rd of the stock market capitalization
- Listed SOEs contribute 10% of GDP

MARKET CAPITALIZATION - PAKISTAN

US \$ 57.37 billion

- Total Market Capitalization

US \$ 18.87 billion

- Market Capitalization of Multinational Companies (\approx 33%)

US \$ 16.27 billion

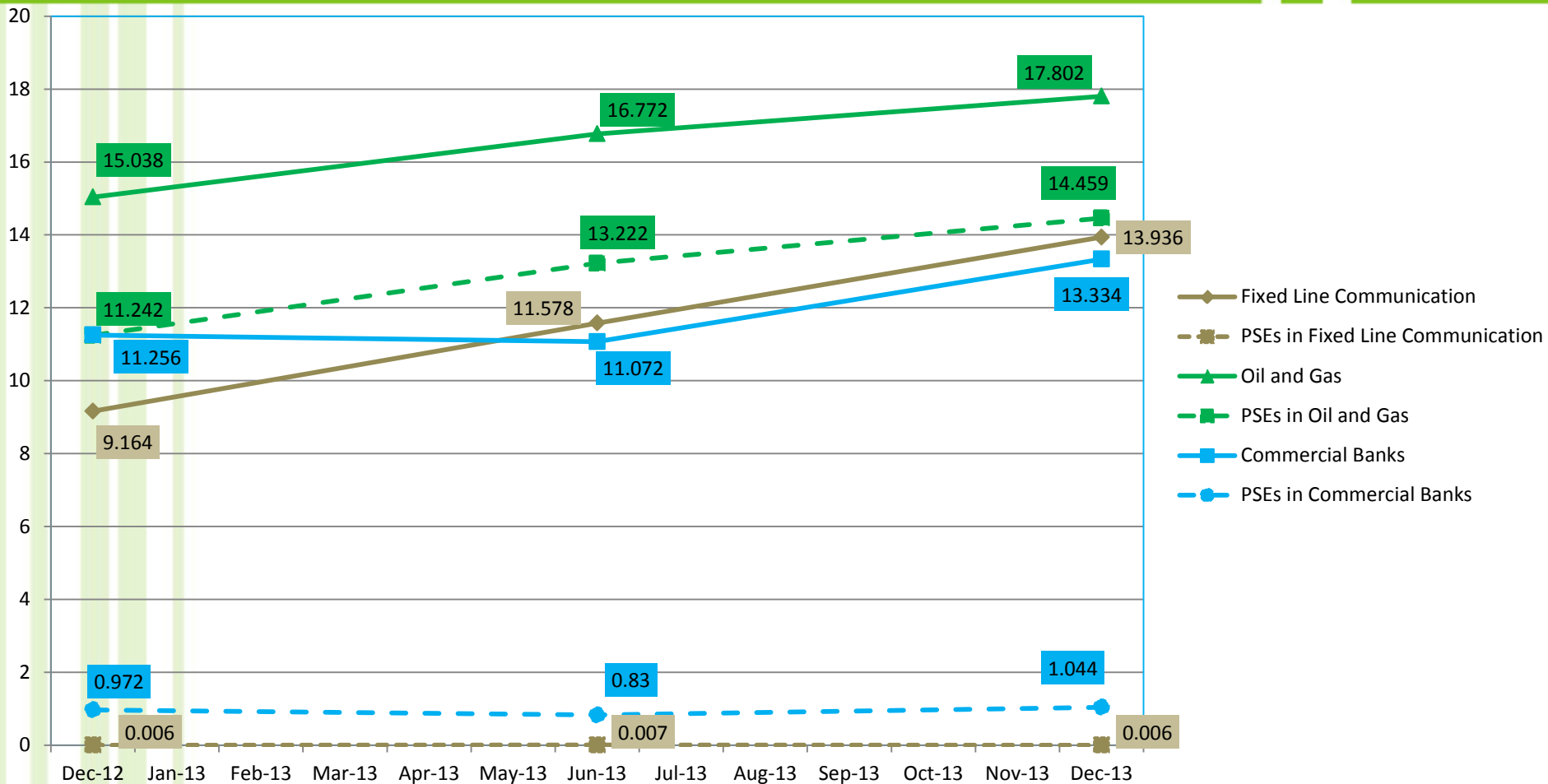
- Market Capitalization of Public Sector Companies (\approx 28%)

US \$ 22.23 billion

- Market Capitalization of Others (\approx 39%)

- *As on December 31, 2013*

COMPARISON OF PSCs WITH INDUSTRY SECTOR – TREND IN 2013



- All figures are in billion US dollars.
- Data for PSEs represent 95% of total market capitalization of PSEs

DEVELOPMENT OF A CG CODE FOR PSCs IN PAKISTAN

2007

SECP issues draft PSC
(Corp. Governance)
Regulations

2009/2011

Draft was updated.
Review of Draft by
Economic reforms Unit
of (Ministry of Finance)
Taskforce

2012

First draft of regulations
issued for public
comment. The
consultative document
underwent public
debate engaging various
stakeholders

March 8, 2013

PSC (Corp. Governance)
Rules issued.
Effective August 8, 2013



Applicable to all Public
Sector Companies,
whether listed or not,
except those which are
established under a
Special Act of the
Parliament

PSC (Corp. Gov.
Compliance) Guidelines,
2013

- Statement of compliance
- Review report from external auditors

GOVERNANCE CONCERNS IN THE PUBLIC SECTOR

Lack of private ownership

- Inappropriate accountability mechanism
- Lethargy in decision making

Lack of attention to good governance

- No training of politicians.
- No focus on long-term sustainability

LESSONS LEARNED

Lack of transparency

- No policies on ethics, conflict of interest, and anti-corruption, etc.
- Non-listed PSCs avoid publishing financial statements

Lack of empowerment to boards

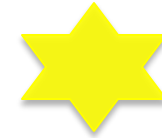
- CEO appointed by Government without engagement of boards

PRIORITIES IDENTIFIED & BEING ADDRESSED

- Increase competencies in SOE boards
- Selection of the CEO
- Provide proper training to board members,
including induction training

GOING 'GLOCAL'

Major Accomplishments



- **Board structure & composition made more effective**
 - Requirement of fit & proper test for members
 - Majority to be independent directors
 - Separation of Chairman/CEO
- **Political intervention minimized**
- **Publishing of Annual Report including annual financial statements on website**

PERFORMANCE OF BOARDS OF INDIVIDUAL PSCs

Shortcomings:

- Lack of transparency in appointment and election of members
- Absence of formulated strategy making process
- Lack of independence on boards

Need to:

- Develop a structured and transparent board nomination process
- Ensure boards are actively engaged in shaping strategy
- Increase independence of boards

Solution - Ensure PSCs are subject to a robust audit system

WHAT LIES AHEAD ? – THE CONDUCT OF STATE-OWNERSHIP FUNDS - 1/2

- Have a transparent and clear strategic approach to all SOEs
- Complete the corporatization process & harmonize legal status
- Require large SOEs having substantial public interest, to be as transparent as listed companies
- Clarify business objectives and make non-commercial ones (due to public policy) explicit
- Avoid interference by Government in SOE management
- Ensure arms length relationship between SOEs, state-owned banks and other financial institutions

WHAT LIES AHEAD ? – THE CONDUCT OF STATE-OWNERSHIP FUNDS - 2/2

- Publish aggregate reports on state ownership
- Make the ownership entity additionally accountable to parliament and subject to state audit
- Ensuring a level playing field in market for effective competition between state-owned and private sectors and avoiding market distortions
- State acts as an informed and active owner with clear ownership policy to enable transparent and effective functioning of SOE

ISSUES THAT PERSIST FOR PAKISTAN PSCs

FORMATION OF BOARD COMMITTEES

- Lack of qualified NEDs to chair committees
- Commensurate remuneration of NEDs

INDEPENDENT DIRECTORS

- 40% of the Board within two years and then majority thereafter – kick start delayed?

CEO APPOINTMENT - (FIT AND PROPER CRITERIA)

- Selection of candidates by Board, need to include in selection criteria the experience, and ability to represent a cohesive vision and strategy
- Option with government to choose out of three proposed
- Board has the final decision to hire once government chooses

COMMITMENT TO GOOD GOVERNANCE

- Limit on number of directorships excludes subsidiaries of companies. Lack of time availability for proper focus?

AND THE REAL CHALLENGE

- Change of behavior in mind and heart
- Political will to bring about growth in long term sustainable value
- Implementation beyond rules & legislation



PAKISTAN PSC RULES MEASURE UP TO OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

[DRAFT ISSUED FOR PUBLIC COMMENT – MAY 2014]

Focus areas – Principles II, IV, V, VI, VII
(slides 16 through 28)

II. THE STATE'S ROLE AS AN OWNER

The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, in accordance with the ownership policy and with the necessary degree of professionalism and effectiveness.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 16

- Every Public Sector Company shall adopt International Financial Reporting Standards, as are notified by the Commission under clause (i) of sub-section (3) of section 234 of the Ordinance.

IV. EQUITABLE TREATMENT OF SHAREHOLDERS AND OTHER OUTSIDE INVESTORS

Where SOEs are listed on stock exchanges or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 3 (6)

- The Public Sector Company shall, where necessary, take necessary steps to ensure that the minority shareholders, as a class, are facilitated by proxy solicitation

V. STAKEHOLDER RELATIONS AND SUSTAINABLE BUSINESS

The state ownership policy should fully recognize SOEs' responsibilities towards stakeholders and request that they report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 5 (5)

- The Board shall establish a system of sound internal control, which shall be effectively implemented at all levels within the Public Sector Company, to ensure compliance with the fundamental principles of probity and propriety; objectivity, integrity and honesty and relationship with the stakeholders

•Regulation 5 (7)

- The Board shall also formulate significant policies of the Public Sector Company, which may include the following, namely:-

- b) The implementation of an effective communication policy with all the stakeholders of the Public Sector Company

VI. TRANSPARENCY AND DISCLOSURE

SOEs should observe high standards of transparency and disclosure and be subject to the same high quality accounting and auditing standards as listed companies.

A. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 22 (1)

• There shall be an internal audit in every Public Sector Company. The chief internal auditor, who is the head of internal audit function in the Public Sector Company, shall be accountable to the audit committee and have unrestricted access to the audit committee.

VI. TRANSPARENCY AND DISCLOSURE

SOEs should observe high standards of transparency and disclosure and be subject to the same high quality accounting and auditing standards as listed companies.

B. SOEs should also be subject to an annual independent external audit based on internationally recognized standards. Specific state control procedures do not substitute for an independent external audit.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 23 (1)

•Every Public Sector Company shall ensure that its annual accounts are audited by external auditors, as envisaged under section 252 of the Ordinance. When carrying out audit of a Public Sector Company, the external auditors shall take in to account the specific requirements of any other relevant regulations, ordinances or ministerial directives which affect the audit mandate and any special auditing requirements.

VI. TRANSPARENCY AND DISCLOSURE

SOEs should observe high standards of transparency and disclosure and be subject to the same high quality accounting and auditing standards as listed companies.

C. SOEs should disclose material financial and non-financial information on the company in line with high quality internationally recognized standards of corporate disclosure, and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest.

Public Sector Companies (Corporate Governance) Rules, 2013

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C. 4. Information on board member remuneration policies and levels as well as board member qualifications, selection process, roles on other company boards and whether they are considered as independent by the SOE board;

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 19 (1)

• There shall be a formal and transparent procedure of fixing the remuneration packages of individual directors. No director shall be involved in deciding his own remuneration.

VII. THE RESPONSIBILITIES OF THE BOARDS OF STATE-OWNED ENTERPRISES

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 5 (1)

•The Board shall exercise its powers and carry out fiduciary duties with a sense of objective judgment and independence in the best interests of the company.

Regulation 5 (3)

•The Board shall ensure that obligations to all shareholders are fulfilled and they are duly informed in timely manner of all material events through shareholder meetings and other communications as are considered necessary.

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B. SOE boards should effectively carry out their functions of setting strategy and supervising management, based on a broad mandate set by the government. They should have the power to appoint and remove the CEO.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 5 (2)

- The Board shall evaluate the candidates based on the fit and proper criteria and the guidelines specified by the Commission for appointment to the position of the chief executive ...
- The Board shall also be responsible for development and succession planning of the chief executive.

Regulation 5 (6)

- The Board shall adopt a vision or mission statement and corporate strategy for the Public Sector Company.

Regulation 7 (1)

- The Board shall establish appropriate arrangements to ensure that it has access to all relevant information, advice and resources necessary to enable it to carry out its role effectively. Significant issues are placed before the Board for their information and consideration, in order to formalize and strengthen the corporate decision making process.

Regulation 8 (2)

- The Board shall monitor and assess the performance of senior management on a periodic basis, at least once a year, and hold them accountable for accomplishing objectives, goals and key performance indicators set for this purpose.

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C. SOE board composition should allow the exercise of objective and independent judgment. All board members, including any public officials, should be nominated based on qualifications and have identical legal responsibilities.

F. The Chair should assume responsibility for boardroom efficiency and, when necessary in coordination with other board members, act as the liaison for communications with the state ownership entity. The roles of CEO and Chair should be separate.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 3

•The Board shall consists of executives and non-executive directors, including independent directors and those representing minority interests with the requisite range of skills, competence, knowledge, experience and approach so that the Board as we group includes core competencies and diversity considered relevant in the context of the Public Sector Company's operations.

Regulation 3 (2)

•The Board shall have forty per cent of its total members as independent directors within the first two years of this notification, which shall be raised to a majority of independent directors in the next two years, and the majority shall be maintained subsequently. The Public Sector Company shall disclose in the annual report Non-executive, Executive and Independent directors.

Regulation 4

- The office of Chairman shall be separate, and his responsibilities distinct, from those of Chief Executive.

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G. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 3 (7)

•Appointing authorities including Government and other shareholders, shall apply 'fit and proper' criteria *as provided* in making nominations of the persons for election as Board members under the provision of the Ordinance.

Regulation 5 (5) (c)

•Principle of relationship with stakeholders require –
(ii) ensuring equality of opportunity by establishing open and fair procedures for making appointments and for determining terms and conditions of service. Boards shall nominate a committee, one of its members or senior executives for investigating, where necessary, on a confidential basis, any deviation from company's code of ethics.

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The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

H. When necessary, SOE boards should set up specialized committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. The establishment of specialized committees should improve boardroom efficiency and should not detract from the responsibility of the full board.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 12

•The Board shall set up the following committees to support it in performing its functions efficiently, and for seeking assistance in decision making

[These have been identified in the Rules as: Audit Committee, Risk Management Committee, Human Resources Committee, Procurement Committee and Nomination Committee]

Regulation 12 (2)

•The Board committees shall be chaired by non-executive directors and majority of the members shall be independent.

VII. THE RESPONSIBILITIES OF THE BOARDS OF STATE-OWNED ENTERPRISES

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

I. SOE boards should carry out an annual, well-structured evaluation to appraise their performance. The outcomes of the board evaluations should inform the board nomination process.

Public Sector Companies (Corporate Governance) Rules, 2013

Regulation 8

•The performance evaluation of the members of the Board including the chairman and chief executive shall be undertaken for which the Board shall establish a process, based on specific criteria, and the chairman of the Board shall take ownership of such an evaluation.