Governance Related Issues of Stated-Owned Enterprises in Pakistan

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Introduction

SOEs constitute a significant share of Pakistan's economy, contributing about 10 percent of Gross Domestic Product. According to the Ministry of Finance, Government of Pakistan, there are around 200 organizations in Pakistan, which are performing either quasi or fully commercial functions. SOEs exists in many forms such as an autonomous body, attached departments, corporations, and public sector companies under companies' ordinance, 1984. The rationale for the creation of such SOEs was to improve service delivery and fill the investment gaps in the public sector. However, it has been observed that most of the SOEs in Pakistan are making losses and creating a burden on the fiscal exchequer and affecting the overall economic growth in the country. In financial year 2016-17, according to International Monetary Fund (IMF), the combined accumulated losses of Public Sector Enterprises in Pakistan including Pakistan International Airlines (PIA), Pakistan Steel Mills (PSM), Power sector and others have exceeded Rs. 1.2 trillion or 4 per cent of the GDP. The cumulative losses suffered by the PSC's during the last five years (2013-18) comes to Rs. 3.746 trillion.

Successive governments in Pakistan have been attempting to address financial losses of SOEs through subsidies and bailout packages. Most of the literature witnessed the poor performance of SOEs in Pakistan due to poor governance. There are host of structural and procedural governance issues faced by these SOEs. However, this paper analyses the corporate governance issues of SOEs and its impact on performance and service delivery.

Statement of the Problem

The existing literature and debate on the performance of SOEs suggest that there are host of factors leading to poor governance of SOEs such as lack of legislative and regulatory frameworks, poor accountability mechanism, deficient human resource, absence or weak internal controls, and lack of central performance assessment process. However, the most critical governance problems are resulted due to inactive or deficient Board of Directors (BODs) of SOEs. Therefore, it is imperative to examine the role of BODs in depth and find solutions for a useful role of BoDs to improve corporate governance of SOEs in Pakistan.

Review of the literature

A study on corporate governance of SOEs indicates the issues related to SOEs performance. These issues come from various sources, including the need to enhance their competitiveness and that of the economy as a whole, especially in countries where SOEs are major players; to provide essential infrastructure, financial, and other services to businesses and consumers more efficiently and cost-effectively; to reduce their fiscal burden and fiscal risk; and to enhance the transparency and accountability of the use of scarce public funds. A

[1] *The Author wrote this article as part of the requirement of Senior Management Course at the National School of Public Policy,Pakistan*
[2] *Asian Development Bank, "Report and Recommendations of the President to the Board of Directors", (Manila: Asian Development Bank, 2014), p.1*
[3] *Ministry of Finance, Government of Pakistan. "Sate Owned Enterprises Performance Review." Islamabad, 2014-15. http://www.finance.gov.pk/publications/State_Owned_Entities_FY_2014_15.pdf (accessed 22 March, 2018)*
[4] *"Public Sector Companies losses Swells to Rs. 1.2 Trillion", The News, Rawalpindi, March 20, 2018*
[5] *Bilal Hussain, "Public Sector Units Suffer Hefty Rs. 3.74 trillion loss over five years, The Express Tribune, May 16, 2018, www.tribune.com (accessed on May 16, 2018)*
[6] *Ishrat Hussian, "Governing the Ungovernable." Karachi: Oxford University Press, 2018. 443-453.*
[7] *Asad Ali Shah, the former Advisor on Finance to Chief Minister Sindh, Pakistan has defined "Corporate Governance is the system and processes by which the entities are controlled, directed, and held accountable to enhance the performance and sustainable shareholder value", Asad Ali Shah, "State Owned Entities & Privatization Process in Pakistan" (Lecture, National Institute of Management, Islamabad, 15 March, 2018)*

long history of efforts at reform shows that the key to better SOE performance is better governance.

The weak corporate governance will continue to pose challenges regarding transparency, lack of clarity of roles, political interference and ineffective oversight by the BODs that create difficulties for the SOEs to operate efficiently and vibrantly. BODs remains the governing body responsible for overall governance of the SOE under the law, however, the immense authority of line ministries and other public office holders, drawn from the government, hinders the BODs in exercising effective oversight role, carry out strategic planning and hold CEO and management accountable as they are often directly appointed by the government instead of BODs.

There is sufficient institutional framework of Corporate Governance in Pakistan and it has developed good corporate governance laws but poor implementation of these laws together with political instability adversely affect corporate governance in the country.

There is no clear theoretical case either for or against SOEs. Undoubtedly many SOEs are inefficient, dynamic, and corrupt. However, there is no clear, systematic evidence that SOEs are burdens on the economy. Furthermore, there is a certain degree of "selection bias" in the empirical materials relating to SOEs in the sense that poorly performing SOEs tend to be discussed more. It is natural that people talk more about problem cases, but this gives the wrong impression of the prevalence of inadequate SOE performance.

Rationale of SOEs- International Perspective

The global financial crisis of 2008 proved a significant setback to the privatization process that was initiated in many countries during the 1990s. The global public debts were enhanced much fold as a result of this crisis. A new debate on the effective public financial management and corporate governance of the SOEs came to the limelight. One of the major lessons of the financial crisis was to improve corporate governance of the SOEs to ensure better financial management. The outcomes of an international survey found that SOEs account for about 80% of the market capitalization in China, 35% percent in Brazil and 60 % in Russia. State-owned enterprises (SOEs) are now responsible for approximately one-fifth of global stock market value. The form and structure of SOEs, however, varies in different countries in terms of their ownership structures. There are broadly three models of state ownership of SOEs which are explained below:-

Table. 1 Models of State ownership of SOEs

Decentralized Model	Dual Model	Centralized
Line ministries responsible (e.g., Pakistan) I. Line ministries have historical experience, sector/company knowledge ii. However, many limitations - Conflicts between ownership, policy-making and regulatory function iii. Fragmentation of ownership - Insufficient "ownership" capacity iv. Lack of adequate oversight and accountability of sector as a whole	Line ministries & another ministry, usually MOF (e.g., Turkey, Mexico) * A hybrid between decentralized and centralized model - Provides checks and balances - Promotes technical and financial oversight * Limitations: - MOF focused more on financial and budgetary matters - Lack of capacity to be an advocate for reform - Numerous other bodies continue to be involved	Three broad types: - Advisory bodies (e.g., Norway, Sweden, New Zealand, India, S.A.) - Ownership agencies within the government structure (e.g. France, Indonesia, China) - Holding companies (e.g. Malaysia, Singapore, Hungary, Gulf countries) * Benefits: - Separates and strengthens the ownership function and ensures consistent implementation - Concentrates scarce skills and resources - Helps drive reform

[8] *State-Owned Enterprises: A Toolkit." 2014 <http://documents.worldbank.org/curated/en/228331468169750340/pdf/913470PUB097810B00PUBLIC00100602014.pdf (accessed on April 10, 2018)*

[9] *Muhammad Naveed Iftikhar, "State-Owned Enterprises in Pakistan: The Need for Corporate Governance and Private Investment." Policy Research Institute of Market Economy, (August 2015).*

[10] *Attiya Y. Javaid and Robina Iqbal, "Corporate Governance in Pakistan: Corporate Valuation, Ownership and Financing." PIDE Working Paper,. Islamabad: Pakistan Institute of Development Economics, 2010. p.16.*

[11] *Joon-Chang, Ha, "State-Owned Enterprise Reform", National Development Strategies Policy Notes. United Nations Department for Economic and Social Affairs, 2007. pp. 7-8.*

Source: Sunita Kikeri, "Global Trends and Developments in SOEs Corporate Governance", a paper presented at the World Bank workshop on corporate governance of SOEs held in Turkey, June 10, 2014

Organization of Economic Cooperation Development (OECD) and the World Bank have produced guidelines of corporate governance of SOEs. The fundamental purpose of these guidelines is to ensure transparency, accountability, and effectiveness of SOEs. The comparative analysis of the OECD and the World Bank guidelines on SOEs is given in the following table: -

Table. 2: Guidelines on Corporate Governance

Decentralized Model	The World Bank Guidelines
1. Ensure a level-playing field with the private sector 2. Reinforce the ownership function within the state administration 3. Provide equitable treatment of minority shareholders 4. Improve transparency of SOEs' objectives and performance 5. Improve stakeholder relationship 6. Strengthen and empower SOE boards	1. Sound legal and regulatory framework 2. Professionalized state ownership 3. Good Board and management practices 4. Robust Regime of disclosure and transparency 5. Shareholder/stakeholder treatment

Source: Constructed by the author from the OECD and the World Bank documents

The careful examination of OECD and the World Bank guidelines reveal that many principles are in common like ownership function, improved transparency, strong regulatory framework and robust board management practices. Both these organizations have accessed the degree of compliance of these corporate principles in many countries. For instance, various countries like Finland, Hungary, Namibia, Philippines, Poland, and Romania have ownership legislation. Whereas countries like Bhutan, Finland, Norway, Sweden have ownership policies. Similarly, Egypt, Germany, India, Kenya, Malawi, Malaysia, Mozambique, Mauritius, Morocco, Peru, Poland, Seychelles, South Africa have developed corporate governance codes/guidelines.

The Board Composition, Role and Independence

The BODs play a crucial role in the governance and management of SOEs. SOE board approves strategy and monitors management of the organization. The Boards also set strategic direction and take major decisions. The boards also appoint and oversee management of the SOEs. OECD defines the following responsibilities of the boards of SOEs:-

I. The board should have a clear mandate and ultimate responsibility for the company's performance

ii. The board acts according to objectives set by the ownership entity. It has the power to appoint and remove the CEO.

iii. The board is composed so that it can exercise objective, independent judgement.

iv. The Boards should have employee representation.

v. Specialised board committees should be considered.

vi. Annual board evaluation should be published.

vii. Monitor the effectiveness of the company's governance

viii. Select, monitor and, if necessary, replace executives

ix. Align remuneration with the longer-term interest of the company

x. Ensure formal and transparent board nomination practice

xi. Monitor potential conflicts of interest in the organization

It is common practice globally that capital market listing rules and company bylaws require utilities to have a Board of Directors for the issuance of bonds or shares. Board members play the primary role of ensuring that all the management of the company act

[12] *"The Company that Ruled the Waves", Economist, Dec. 17, 2011,*
< https://www.economist.com/node/21541753> (accessed on April 17, 2018)

[13] *Sunita Kikeri, "Global Trends and Developments in SOE Corporate Governance", a paper presented at the World Bank workshop on corporate governance of SOEs held in Turkey, June 10, 2014*

[14] *"OECD Guidelines on Corporate Governance of State-Owned Enterprises", (2015 Edition),*
< http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm> (accessed on April 17, 2018)

[15] *"Corporate Governance", The World Bank,*
< http://www.worldbank.org/en/topic/financialsector/brief/corporate-governance> (accessed on April 17, 2018)

in the interests of the shareholders, through monitoring and an advisory role. The Boards formulated through the certain regulations about some directors for the company, their types of independent directors, executive, and non-executive members as well as required skills of the appointees. Corporate governance regulations have specific requirements like frequency of meetings of the Board. According to corporate governance rules, there should be Board committees. Appointment of highly qualified professional meeting certain criteria are also the requirement to fulfill the corporate governance rules. The appraisal of the BoDs performance is also an essential aspect of it.

Many politicians and public officials in developing countries have used SOEs to provide gifts (transport, housing), Board membership, jobs for themselves relatives and supporters, and in some cases even procurement kickbacks. A particular problem that seems to be emerging in developing countries is the excessive turnaround of directors which does not allow them to exercise any influence in corporate events.Policymakers in several countries have turned to independent directors as an essential element of legal and policy reforms in the field of corporate governance. In the United States, insider-dominated Boards have been rare for years. Although the New York Stock Exchange (NYSE) has required that independent directors constitute a Board majority in domestic companies only since 2004, as of 2001 approximately 75% of NYSE-listed companies already had such majorities. Under the current NYSE listing rules, the Board overall must have a majority of independent directors.

The experience of BODs of SOEs in some emerging economies is particularly enlightening. The Chinese model of appointment of independent directors to the Boards of SOEs is pre-dated the corporate scandals that led to federal-level corporate governance reforms in the United States, possibly because of the many similar scandals. In August 2001, the China Securities Regulatory Commission (CSRC) issued its Guidance Opinion on the Establishment of an Independent Director System in Listed Companies.In response to the 1997-1998 East Asian financial crisis, Korea adopted corporate governance rules in 1999, requiring "large" firms to have 50% outside directors. Smaller firms must have 25% outside directors. India's also adopted significant governance reforms in 1999, such as Clause 49 which requires, among other things, audit committees, a minimum number of independent directors, and Chief Executive Officer (CEO)/Chief Financial Officer (CFO) certification of financial statements and internal controls.

There are four mechanisms through which BODs independence can be ensured. The first one is to tighten the standards and rules of disqualifying relationships, including current employment by the firm and dimensions of potential connectedness. Throughout the 80s and 90s, panels and "blue ribbon" committees developed influential "best practice" guidelines for relationship tests. The principles of corporate governance recommended that the Board of a public corporation "should have a majority of directors who are free of any significant relationship with the corporation's senior executives".

The second mechanism for independence is to increase penalties and incentives, such as legal liability for fiduciary duty breach, reputational sanctions, and stock-based compensation. Directors also potentially face liability under the federal securities laws for material mis-statements or omissions in a corporation's financial disclosures. A third mechanism to enhance the independence of the members of the Board of Directors is the development of intra-Board structures, such as task-specific committees and designation of a "lead director". This may enhance independence in two ways: 1) the ownership and accountability for a specific critical task may lead to greater autonomy from the CEO in performing that task, 2) the practice of acting jointly and autonomously in a targeted area may carry over to other important roles of the Board".

In a nutshell, the transformation of SOEs from a government department to the corporation under corporate governance rules and the company ordinances poses formidable challenges. At the same time, it presents several potential opportunities. Corporate Governance brings about insulation. It allows company laws to limit the right of shareholders to manage the enterprise directly. The decision-making role is delegated to the chief executive officers under the corporate rules. Overall, the management is monitored through company's BoDs. Being the shareholder of SOEs, the government has a legitimate

[16] *Sunita Kikeri, Op.cit.*
[17] *Ibid.*
[18] *ECD (2015), OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264244160-en. (accessed on April 10,2018)*

right to influence SOEs. Although, the extent of influence and the scope in practice has been excessive. It calls for some limitations. Government role should be limited to the objectivity of outcomes and regulations of the corporate laws instead of influencing and managing the management.

Pakistan's Experiences with SOEs

Pakistan inherited 12 major SOEs in 1947. The policy and objectives of SOEs were indicated in Industrial Policy of 1948. Pakistan Industrial Development Corporation (PIDC) was established in 1952. Its charter reflected objectives of SOEs in Pakistan. During the 1950s and the 1960s, SOEs were set up in all the sectors of the economy, i.e. water and power, finance, transport, agriculture etc. A concept of " Government by the Corporation" was implicitly evolved in the 1960s. Public Corporations in Pakistan emerged as well-run entities. Following Nationalization, in early 1970s public sector expanded radically. Expanded public sector confronted challenging task for improving operational efficiencies of SOEs. A number of high-powered commissions/ committees i.e. H.U .Baig committees, Uquaily commission, etc were constituted to examine the existing system and make recommendations for improvement. In last few years, corporate governance emerged as one of the most practical models to run the SOEs particularly in the field of utility services. Today, Pakistan has SOEs in all sectors of the economy such as financial, trading, services, transportation, and promotional and advocacy sectors.

The performance of SOEs in Pakistan is crucial for sustainable economic growth and effective service delivery. The SOEs constitute about 10 per-cent of the GDP in Pakistan and have been established in all major sectors of the economy like energy, infrastructure, and communication and, the financial sector. The underlying purpose for the creation of SOEs in Pakistan was to develop infrastructure in major areas of the economy where private sector did not have incentives for investment. However, with the passage of time, SOEs faced problems, resulted in as a burden on the economy and creating fiscal problems for the government. These SOEs have become a liability on the part of the government as it consumes major chunk of government resources in the form of sub-sidies and bail-out packages. According to the IMF report " the combined accumulated losses by these SOEs now exceed Rs.1.2 trillion (4 percent of the GDP) which could eventually lead to sizable demand for budgetary resources". During the tenure of Pakistan People's Party (2008-13), the performance of SOEs was not encouraging as these enterprises recorded an average loss of Rs. 400 billion annually. Besides, the SOEs have accumulated enormous domestic and external public debts during the recent years. The following table highlights the debts owned by the SOEs during the last five years.

Table 3. Year wise Debt of Public Sector Enterprises in Pakistan (Rs in Billions)

Year	Domestic Debt	External Debt
2013	312	183
2014	366	204
2015	459	253
2016	568	294
2017	823	284

[19] *Benjamin E. Hermalin and Michael S Weisbach. "The effects of Board composition and direct incentives on firm performance." Financial Management 20 (1991), pp. 101- 112.*

[20] *Craig, G. Doidge, Andrew Karolyi, and René M. Stulz . "Why do countries matter so much for corporate governance?" Journal of Financial Economics, 2006.*

[21] *World Bank Group, International Bank for Reconstruction and Development,. "Corporate Governance of State-Owned Enterprises: A Toolkit." 2014 < http://documents.worldbank.org/curated/en/228331468169750340/pdf/913470PUB097810B00PUBLIC00100602014.pdf (accessed on April 10, 2018)*

[22] *Jay Dahya John J. McConnell, "Board Composition, Corporate Performance, and Cadbury Committee Recommendation." Journal of Financial and Quantitative Analysis, forthcoming, 2007.*

[23] *OECD, Policy Brief on Corporate Governance of State-Owned Enterprises in Asia: Recommendations for Reform. Paris: OECD-Asia Network on Corporate Governance of State-Owned Enterprises, OECD, 2016.*

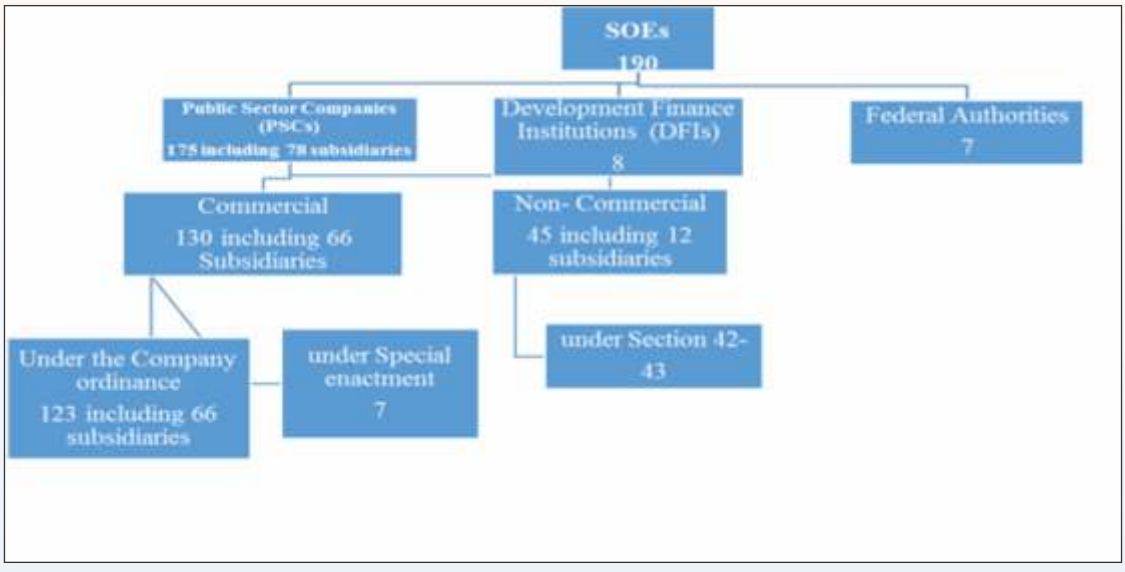
[24] *Tamunu, M. and Tumewu, F. "Analyzing The Influence Of Price And Product Quality On Buying Decision Honda Matic Motorcyles In Manado. , Manajemen,." Jurnal Riset Ekonomi (Bisnis Dan Akuntansi) 2(3) (2014).*

[25] *Khanna and Vagliasindi. "Overview of SOE corporate governance rules best practice and transpositions to emerging countries." 2007.*

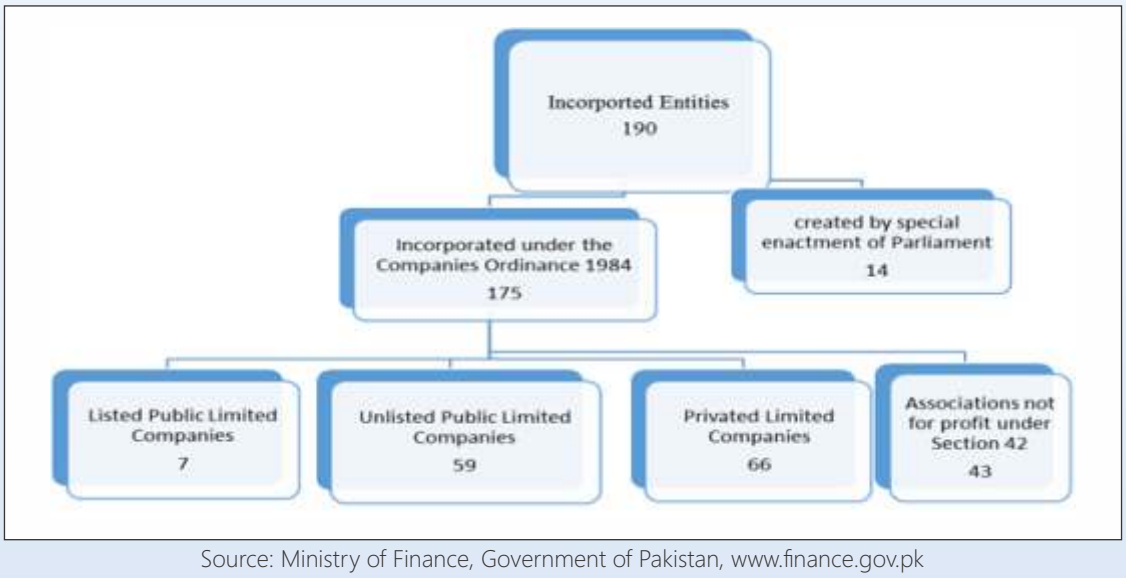
Source: State Bank of Pakistan, Annual Report, 2017 www.sbp.gov.pk

Pakistan has the heterogeneous legal structure of SOEs. At present, Pakistan has 190 SOEs in various sectors. These SOEs are categorized under Public Sector Companies, Development Finance Institution and, Federal Authorities. Out of 190 SOEs, 175 entities are incorporated under company's ordinance 1984 whereas 14 have been created under special enactment of the parliament as autonomous bodies or attached departments. The federal and provincial authorities are not following the corporate governance rules issued by the Securities and Exchange Commission of Pakistan since these are not governed under company's ordinance 1984. The following diagrams explains the legal structure of SOEs in Pakistan.

SOEs Classification[36]



Incorporation Structure of the SOEs



Source: Ministry of Finance, Government of Pakistan, www.finance.gov.pk

[26] *"Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies", China Securities Regulatory Commission, < http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/200708/t20070810_69191.html> (accessed on April 17, 2018)*

[27] *Ibid*

[28] *Tamunu, M. and Tumewu, F. "Analyzing The Influence Of Price And Product Quality On Buying Decision Honda Matic Motorcyles In Manado. , Manajemen,." Jurnal Riset Ekonomi (Bisnis Dan Akuntansi) 2(3) (2014).*

[29] *Joon-Chang, Ha. "State-Owned Enterprise Reform." National Development Strategies Policy Notes. United Nations Department for Economic and Social Affairs, 2007. pp. 7-8.*

[30] *Hermalin, Benjamin E., and Michael S. Weisbach. "Endogenously chosen Boards of directors and their monitoring of the CEO ." American Economic Review 88 (1998): pp.96-118.*

[31] *Hermalin, Benjamin E., and Michael S Weisbach. "The effects of Board composition and direct incentives on firm performance." inancial Management 20 (1991): 101- 112.*

[32] *Adams, Renee B., and Daniel Ferreira. "A Theory of Friendly Boards." Journal of Finance 62 (2006).*

The regulatory framework of SOEs in Pakistan

The regulatory framework is divided into two categories, i.e. Institutional Framework and Legislative Framework. Institutional Framework: Federal government of Pakistan holds the majority of the shares of SOEs. It is automatically responsible for their management control. There are seventeen ministries engaged in the administration of the 190 SOEs in Pakistan. Out of these entities, most of the SOEs are concentrated under three central ministries. These include Ministry of Industries & Production, Ministry of Finance, and Ministry of Water & Power. About 31 SOEs are directly controlled by the Ministry of Finance. These SOEs belong to the financial sector including Development Finance Institutions (DFIs) and Banks. The entities from 'Industrial & Engineering' sector and 'Promotional & Advocacy' sector controlled by the Ministry of Industries & Production. About 25 Public Sector Companies (PSCs) and one Federal Authority (WAPDA) are under the supervisory role of Ministry of Water and Power. These PSCs belong to 'Power' sector. These are involved in power generation, distribution and transmission, and other relevant functions. Securities and Exchange Commission of Pakistan (SECP) performs the function of regulator of Public Sector Companies (PSCs) registered under Companies Ordinance, 1984.

Legislative Framework:

There is no specific legislation for SOEs in Pakistan. However, the SECP notified the rules for the corporate governance of public sector companies in 2013. These rules apply to all public sector companies, directly or indirectly, owned and controlled by the government. These rules were aimed at empowering the boards of PSCs and for creating greater transparency and accountability. The development of these corporate governance rules was considered as a first significant step towards the improvement in corporate governance processes of SOEs. These rules have also helped clarify roles and responsibilities of different stakeholders involved in governance and management of SOEs.

SOEs faced several governance problems regarding their structures and processes in Pakistan. These governances include, amongst many other transparency, accountability, weak performance evaluation and, insufficient or weak regulatory framework. Some of the major governance problems of the SOEs in Pakistan are given as under:

I. **Heterogeneous Governance Regimes.** The heterogeneous legal structures of SOEs in Pakistan weakens the regulatory framework. As stated earlier, among other things, the Corporate Governance Rules 2013 are applicable to select numbers of PSCs like Companies registered under Companies Ordinance 1984 (for and not for profits).

ii. **Weak Boards of Directors:** The system of appointment, training, remuneration and performance evaluation of BODs of SOEs is not transparent and affects the performance of these organization. In most of the cases, BODs are appointed by the government which compromises their autonomy in decision making. The Chief executive Officers or Chairperson of SOEs are most of the time from governments sector. The SOEs also do not have a proper and regular system of training of its Board members.

iii. **Absence of Performance Evaluation System:** The absence of performance evaluation system for the managers is frequently the major cause of inefficiencies in the SOEs and creates vagueness about their goals. A performance evaluation system, which is based on clear and quantifiable targets and linked with an incentive system minimizes vagueness and motivates managers to achieve specified performance level. Performance evaluation system was introduced in Pakistan through the "Signalling System for Public Enterprises" in 1980s but was abandoned in 2000.

iv. **Budget Constraints:** Historically, SOEs in Pakistan faced budget constraint, compared to their private sector counterparts. It leads to non-commercial decision-making and lack of financial prudence. The successive federal government continued to provide support in the form of investments, subsidies, bailout packages, grants, guarantees and public sector loans to enable SOEs to obtain loans from commercial banks. This has resulted in fiscal challenges and exposed the government

[33] *"State Owned Entities (SOEs) Performance Review (FY 2013-14)", Ministry of Finance, Government of Pakistan* http://www.finance.gov.pk/publications/State_Owned_Entities_FY_2013_14.pdf (accessed on April 15, 2018)

[34] *Khaleeq Kiani, "PML-N's unfulfilled Promises: Public sector enterprise", Dawn, April 02, 2018.*

[35] *Bilal Hussain, op.cit.*

to risks of fiscal instability along with financial mismanagement in some SOEs..

v. **Weak Compliance with Corporate Governance Rules:** Although, SECP mandated to carry out supervision and enforcement of corporate governance to ensure compliance by the SOEs. However, the compliance rate of Corporate Governance rules for the fiscal year 2015 reached the level of 37 per cent. These efforts of SECP are appreciable, but still, SECP faces challenges regarding directing the government to comply with the requirements of the rules and holding government functionaries accountable.

vi. **Politicization:** In Pakistan, SOEs perceived as tools to achieve political objectives of the government and in some case interests of the individual's politicians. The politics of clientelism gave importance to the idea of keeping SOEs in traditional mode instead of promoting the culture for well-governed entities. This general model has allowed the political governments to influence the service delivery and employment process.

Conclusion

SOEs in Pakistan face many governance issues and have not been to achieve the desirable results in term their contribution to economic growth and public service delivery. Rather these SOEs have proved burden on the national exchequer. The successive governments in Pakistan had to allocate major chunk of their budgetary allocations in terms of subsidies and bail out packages to finance the deficits of SOEs. Though, there is a cluster of governance problems being faced by the SOEs, yet the performance of the BODs is most significant. The investigation of the BODs of SOE's in Pakistan reveals many short comings in their structures and processes. The study could not find the sufficient evidence that corporate governance rule of the SECP were being implemented in letter and spirit in SOEs. There is no formal process of appointment, training, removal and performance evaluation of independent directors of SOEs. The lack of market-based remunerations to the board members have also compromised the quality of board members. The boards are not autonomous in taking important policy decisions.

In the case of USC, the important policy decision like grant of subsidies on utility items is taken by the ministry of Industries and Production rather than board of directors. However, in this case the company should be adequately compensated to fulfill public service obligation which is a scarce practice. Contrary to the best practices, the CEOs of SOE's are appointed by the government and are answerable to the government rather than board members. The institutional arrangements for regulation of PSC's is also very weak and faces many challenges of implementation. The SECP is the main regulator of corporate governance of PSCs established under Companies Ordinance 1984 and have issued corporate governance rules to ensure performance, transparency, financial management, and disclosures of the SOEs. However, the compliance of SECP rules is far from satisfactory. The BoDs of IESCO and USC also suffer many compliance issues as required by the SECP corporate governance rules 2013.

Recommendations

Based on the literature review, international best practices, and analysis of the available data, this study has developed recommendation to improve the corporate governance and performance of SOEs in Pakistan. Considering the complexity of the challenge, the study has decomposed the recommendations in short, medium and long term. While formulating the recommendations, it was considered that they should not be idealistic, and they should be well grounded in the current governance structure of the federal government. The recommendations of the study may also be helpful for the new democratic government to evolve a comprehensive reforms agenda to save the public money and to improve the service delivery by these SOEs.

A) Short Term

I. A detailed corporate governance assessment of all the SOEs in Pakistan should be carried out by a third party. Currently there is no such assessment available to the government. The analysis of two companies i.e. USC and IESCO has revealed that there are severe loopholes in the implementation of corporate governance rules. Such a study for all SOEs can certainly help to develop a comprehensive policy response by the government.

II. The new government should immediately ensure appointment of well reputed professionals and public servants on the board of SOEs. The new boards will undertake immediate measures to reduce losses

[36] *"State Owned Entities (SOEs) Performance Review (FY 2014-15)", Ministry of Finance, Government of Pakistan, http://www.finance.gov.pk/publications/State_Owned_Entities_FY_2014_15.pdf> (accessed on April 16, 2018)*

and to improve performance of SOEs. It is required to address the overlapping roles and responsibilities of the boards of the directors and management teams as the study found its importance in both USC and IESCO. It is needed to ensure that management team should focus only on operational matters and BoDs should limit their role to the policy decisions.

III. SECP should made the compliance report of all SOEs public in order to ensure transparency and accountability. The public disclosure of compliance will build pressure on SOEs to fulfill the requirements of corporate governance rules in letter and spirit.

IV. Training programs for executives, board members, and senior officers of line ministries should be conducted to impart them contemporary knowledge and skills of corporate governance.

V. The emoluments of senior management of SOEs should be linked to the financial viability of the SOE in order to hold them accountable and to curtail organizational losses.

B) Medium Term

I. Ministry of Finance, Government of Pakistan has recently started publishing an annual report on SOEs but ex-ante goals are not agreed with the SOEs. Thus, the performance is not being reported against such goals. Each SOEs should submit its financial and service delivery goals in advance and then at the end of the year their performance should be benchmarked against those targets. This practice was pioneered by Pakistan through its Expert Advisor Cell of Ministry of Industry and Production for SOEs in the 1980s. However, this practice was abandoned in 2000. Many countries such as India, Philippines, Egypt, Venezuela and Korea adopted this practice and their SOEs performed much better after introduction of such performance agreements. This practice is now being done by Department of Public Enterprise in India, Khazna Model of Malaysia's Treasury, Tamasak Holding of Singapore and Crown Monitoring Agency in New Zealand.

II. There is a need to develop clarity on which SOEs need to be privatized. The new government should do both technical and political consultation to develop a consensus way forward in this regard. This study considers that some of the SOEs such as PIA, Pakistan Steel and other such companies either need private investment or privatization. Generally, Privatization Commission prepares this list with the approval of Council of Common Interest (CCI) but implementation has been weak in this regard.

III. The government needs to restrict its role to improve regulatory quality to attract private sector investments. The policies related to subsidies and notifying the tariff results in an inefficiency of the company performance. For a conducive environment, the government should adopt the corporate governance rules rather than deciding to serve their political interests.

IV. There is a need to develop a formal process for nomination and performance evaluation of Board members of SOEs. A pool of professionals should be developed, and board members should only be nominated from that pool by an independent commission. This will reduce discretionary practices to appoint incompetent board members by the sitting government. The record of previous performance of board members should also be developed and it should be consulted while making board nominations.

V. It is required to create a culture of corporate governance in utility companies in Pakistan. The directors should be made to realize their potential role and must hold equal responsibility and accountability as members of the board. A behavioral change amongst the stakeholders is also needed for democratic values, accomplishing harmony and good governance practices.

C) Long Term

I. Most of the countries, who have managed their SOEs in better way, have introduce dedicated legislations on SOEs in order to ensure

[37] *Pakistan Institute of Corporate Governance, "Report on the Survey on Board Practices of Public Sector Companies in Pakistan". May 2016. PP: 16*

[38] *Ibid.*

[39] *"Challenges in reforming public sector enterprises", Dawn, March 25, 2013*

[40] *Muhammad, Naveed Iftikhar, "State-Owned Enterprises (SOEs) in Pakistan: The Need for Corporate Governance and Private Investment", PRIME Institute, (Islamabad: PRIME Institute, 2015), p.28*

[41] *Istaqbal Mehdi, "Application of Performance Evaluation System and Benchmarking to Improve Operational Efficiency of Public Enterprises", ICPE Public Enterprise Half-Yearly Journal, Volume 22, Issue 1 (2016), p. 92*

[42] *Ishrat hussian, "Recent Privatizations in Pakistan and their Impact." 2009.*

[43] *Attiya Y. Javaid and Robina Iqbal, "Corporate Governance in Pakistan: Corporate Valuation, Ownership and Financing." PIDE Working Papers. Islamabad: Pakistan Institute of Development Economics, 2010. p.16.*

professionalism, accountability and service delivery of SOEs. Pakistan also need to develop a unified structure of all SOEs under such legislation. Currently there are variety of governance mechanism and accountability forums for SOEs which need to integrated and unified. The SOE law should provide a broader framework for governance of SOEs. The same law should clarify roles and responsibilities of all stakeholders involved in the governance of SOEs.

II. Pakistan needs to move towards Singapore's model of Holding Company. All SOEs of Singapore are subsidiaries of its Tamasak Holding Company. Such a holding company will be led by professionals and officers of extreme integrity and dignity. This company in turn will give targets and performance benchmarks to all its subsidiaries.

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