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INSTITUTIONAL INVESTOR'S ACTIVISM AND CORPORATE GOVERNMENT DEVELOPMENT IN PAKISTAN

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ABSTRACT

This study examines the institutional investor's activities that seduce the corporate managers to work in the best interests of their shareholders. Family ownership although removes the agency problem but institutional ownership is more active than family ownership for removing agency problem. This research reveals that for promoting good corporate governance practices institutional investors have more activism.

KEYWORDS: *Institutional Investor, Shareholders, Corporations, Managerial Ownership.*

INTRODUCTION

Mostly the corporations are governed and controlled through the management or board of directors working for the best interests of owners or shareholders. Agency problems are common in every corporation that is a conflict of interest among the management and shareholders. For the assurance of the protection of shareholders the supervisory institution made some rules and laws in every country to save the existing shareholders and to enhance the trust on market efficiency of potential investors.

In response to the problems security and exchange commission of Pakistan made the regulations. Main issue is that whether the management will act ethically on these regulations because the market is not fully efficient in Pakistan there is no guarantee for board that it will make decisions for the best interests of the owners and law doesn't fully protect the investors in developing countries like Pakistan.

So there is need for some influential power that must have the mines of knowledge about the investment opportunities available in for the corporations. A small shareholder cannot have strong influence on the decision making by the managers.

Institutional investors have a strong influence on the decision making by the corporate managers and have knowledge about the statistical tools that ensures the accuracy of financial decisions.

LITERATURE REVIEW

(Shahnawaz Mehmood and Haroon Rasheed) argued that Pakistani code institutional shareholders are the instrumental agents for change in the corporate governance practices of Pakistan. The main source of sudden impact of institutional investors is in two ways, 1st by appointing the new non-executive director and secondly, by the appointment of external auditor. They investigate the pattern of institutional investors that they have large sums of money to invest and these are the heterogeneous groups of having different investment objectives. Institutional shareholder's activism can be if the institutional investors provide the consultancy to corporate managers and investment management services, institutional investors coordinate each other to remove the cost. Researchers categorises them into banking nonbanking and other financial institutions. Institutional investors are more feasible for Pakistan like country where proxy voting is allowed and financial institutions coordinate each other rather to compete and code of ethics here support the role of nominee director as an independent director. All these factors support the activism of institutional investors for removing the agency problem because these investors have access to the sensitive information and effects the managerial decision making.

(Sayeda Saima shabbir 2012) In developing countries ownership is concentrated to institutions pension, insurance and mutual funds. World com and Enron's scandal resulted in the emergence of Sarbanes Oxley Act and it was near about the first law regarding the good corporate governance. In developing countries like Pakistan many code and acts of ethic s are emerged now a days to assure the security of investors for their assets. So there is only institutional investors that could exert their influential power to shape the corporate governance practices of corporation with respect to the listing regulations issued by the security and exchange commission of Pakistan. Institutional investors activism was started in 1980 when pension fund demanded the to protect their rights as investor Cadbury and Green Bury reports and Hamlet reports recognises the role of institutional investors on various of times. ISC institutional shareholder committee was formed in UK to call institutional investors on a platform to have their say and coordinate their activities to support interests of UK investors. Shareholder's activism is in function in Pakistan KOHINOOR's shareholders petition and the court decision was that board member decision was based on limited information.

(Khalil et all 2012) concluded that managerial ownership have negative relation with firm performance. Concentrated ownership has shown insignificant relationship with firm performance. Agency cost increases due to managerial ownership because managers are both owners and also managers and it will be very costly to ensure their decision for the best interests of the rest of all the owners and risk of expropriation also increases.stulls1998 argued that ownership firm value increased a lot then decreased when ownership remain concentrated with insiders.

(Abid et all 2012) shareholders have stakes in the organization so they effect the decision made by the management. They have various potential of bearing risk and this leads the firm towards the success and also could leads towards he failure or bankruptcy. (Wright at all 1996) shareholders with considerable stakes in the organization can shape the nature of its corporate risk taking and rewards between managers and leaders. In Pakistan ownership is mostly concentrated Stulz demonstrated that high level of managerial ownership that allows the managers to block the takeover bids can ultimately lower the firm value. Institutional owners having good knowledge can force the management to work in the best interests of their owners shareholders. (Gedajlovic and Shapiro, 2002) have view that financial institutions are well positioned to monitor the managers of the corporations with in their framework. Ownership is measured in cash flow style rather.

Researcher concluded that different ownership structures provides different results for different performance measures and also created investment opportunities and ownership concentration have strong impact on financial risk taking and by adopting good corporate governance practices corporations can lower the overall risk.

(Arshad Hassan and Safdar Ali Butt, 2009) Managerial ownership has negative relationship with dent to equity ratio indicate that managerial ownership induces managers to lower the gearing level. Institutional ownership have positively related with the capital structure and this relation is insignificant.

(Atiya Javid and Robina Iqbal, 2008) concentration of ownership has impact on quality of corporate governance. Firm specific factor affects the ownership concentration that is more investment opportunities and size leads towards the dilution of ownership. Ownership concentration has most important role in resolving agency problem a conflicts between managers and owners. Absence of legal protection for investor, concentration of ownership has been made a tool for lowering agency problems. In Pakistan concentration of ownership is more because of more week legal environment .concentration of ownership seems to have positive effect on firm's profitability and performance measures. Identity of ownership matters more than concentration of ownership. Family, foreign, and director ownership has more positive effect on firm's profitability. More investment opportunities provides greater opportunity for ownership concentration is endogenous response of poor legal protection for investors and have significant impact on performance.

(Talat Afza and Hammad Hassan Mirza, 2011) institutional owners receives the dividend that is net of tax because tax is calculated at the source on dividend income. (Gravesand Waddock, 1990) argued the institutional owners based on their professional decision making power are more vigilant in controlling agency cost because they enjoy economies of scale in collecting information. Institutional owners have professional managers who apply the statistical tools for analysing risk level and possible return and also could predict somehow correctly the future performance of corporation. Institutional investors are controlling investors and effect largely the corporate decision making.

(Fahad et. All) ownership is one of the factors which have strong functional impact on firm performance. In Pakistan and India family ownership is getting more popularity for governance researchers and investors. Family ownership is best for two reasons because it reduces agency problem and firm owners have more knowledge of in and outside of the corporation and they can make long term decision in more curious ways.

LEGAL ENVIRONMENT IN PAKISTAN FOR INSTITUTIONAL SHAREHOLDER ACTIVISM

A strengthened legal and regulatory framework is necessary for a successful and progressive corporate sector.

The implementation of corporate laws and codes depend much upon the corporate culture of a particular country. USA introduced Sarbanes Oxley Act in 2002 in order to provide stricter and efficient corporate governance standards for avoiding future corporate collapses. It also introduced major changes in the listing standards for the New York Stock Exchange (NYSE) and NASDAQ stock market. These changes fostered an environment for increased shareholder activism. Pakistan being an underdeveloped country with weak economic structure shows poor sense for adoption of good corporate governance practices. Every sector in Pakistan is being politicized and laws are made and enforced not for the protection of general public but for extending favouritism to certain groups. Corporate sector is no exception. Most companies are owned by feudalists who do not enlist their companies on the stock exchanges in order to avoid compliance of legal formalities and payment of taxes.

Section 160 of the Companies Ordinance 1984 of the CCG:-

Section 160(3) of the Companies Ordinance 1984 requires the general meeting of a company to be presided over by the Chairman of the Board of Directors whereas CCG in Para (x) makes it mandatory upon the Chairman of the listed company to preside over the meetings of the Board.

(173(1) of the Companies Ordinance 1984 and of the CCG :-

Section 173(1) of the Ordinance places the responsibility of maintaining proper record of the minutes of proceedings of AGM upon the company itself while as per Para (xii) of the Code the Chairman of the listed company is required to perform this task.

187of the Companies Ordinance 1984 of the CCG:-

Section 187(j) completely debars a person to act as the director of a listed company who himself as a member of the stock exchange is engaged in the business of brokerage. Moreover he\she cannot act so if his/her spouse is a member of the stock exchange and carries out the business of brokerage. On the other hand Para (v) of the Code allows such a person to act as director of a listed company if he seeks exemption from the applicability of this rule, from the Securities and Exchange Commission of Pakistan. This provision of the Code creates confusion for the reason that the Ordinance is to be followed by all the companies compulsorily and contravention of the same entails imposition ofpenalty while the SECP also requires complete compliance of the Code by the listed companies.

Section 224 of the Companies Ordinance 1984 of CCG:-

Directors, officers, major shareholders and any person owning more than ten percent of equity securities as beneficial owner of a listed company are required Section 224 of the Ordinance to make a report of any gain made by them from sale or purchase of such securities within a period of less than 6 months .The concerned person making such gain is also required to tender the same to the company and make intimation to this effect to the Registrar and the Commission. The Code of Corporate Governance on the other hand in Para (xxvi) does not prescribe any time period and simply requires the person making such gain, to notify the same in writing along with the relevant record to the Company Secretary. The Company Secretary then has to place such notice and record before the Board of Directors in its meeting. The Code also prescribes that the listed company shall determine a 'closed period' before the announcement of results, interim or final as the case may be. During the closed period, no person shall be entitled to deal in the shares of that company.

Para (iii) of CCG:-

The Code in Para (iii) postulates that a person cannot act as a director of the listed company if he is also the director of ten other listed companies. Thereby, it means that a person may act as the director of at least ten listed companies at the same time. A person acting as the director of ten listed companies cannot do justice even with the affairs of one company of the ten. The office of the director carries too much responsibilities and the person acting as director is required to show highest level of rationality and prudence in settling the affairs of the company. Such level of prudence and rationality cannot be expected of a person who holds the directorship of so many companies. The Companies Ordinance, on the other hand, is silent as to the number of companies, of which a person may act as director at the same time.

(xvi) And (xvii) of CCG:-

The Code in Para (xvi) while setting out the qualifications of the Chief Financial Officer, prescribes that the person so acting should be either a member of a "recognized body of professional accountants" or a graduate having experience of five years in handling financial and corporate affairs of the listed company, bank or financial institution. This provision of the Code places an ordinary graduate at par with the Chartered Accountant. The success of a company depends upon the transparency and fairness of its financial position. The Chief Financial Officer being responsible to ensure such transparency and fairness should be a professional Chartered Accountant and not an ordinary graduate.

The Code does not debar a person from acting as the Chief Financial Officer as well as the Company Secretary at the same time. A person fulfilling the criteria of qualification as set out in Para (xvi) and (xvii) may act as the Chief Financial Officer as well as the Company Secretary although propriety demands that separate persons should hold these offices. Responsibilities of one office should be exclusive and independent of the other office. Good corporate governance standards can be ensured only when every person carries out his responsibilities exclusively with due diligence. Overburdening a person with two or more offices will result in the reduction of good quality of corporate governance norms.

Section 190 of the Companies Ordinance 1984:-

There are many provisions under the Companies Ordinance 1984 which prescribe nominal penalties for the contravention of the ordinance. Section 190 prescribes a penalty of fine of rupees ten thousand or imprisonment for two years for an un-discharged insolvent who acts as the director, chief executive or managing agent of the company. The courts usually impose fine upon such a person. Therefore the amount of fine to be imposed must not be less than 50,000 at least. The reason being that those persons who being bankrupts act as directors, managing agents or chief executives , are likely to act to the detriment of the company and its shareholders. Therefore exemplary punishments should be imposed in order to prevent such behaviour for future prosperity of the company.

Section 189 of the Companies Ordinance 1984:-

Section 189 of the Companies Ordinance prescribes the imposition of fine of just 200 rupees for each day upon the person who is not qualified to act as director or chief executive of the company, but he acts so. The amount of fine should not be imposed on daily basis but should be a fixed amount. Whether the unqualified person acts for few days or so many days as director or chief executive he should be penalized strictly. A person not qualified to act as director or chief executive, if makes gain of huge amount of money and also acts in detriment to the interest of investors in just few days, then paying 200 rupees per day does not cost him anything.

Section 193 of the Companies ordinance 1984:-

Section 193 of the Companies ordinance 1984, postulates the quorum for a meeting of directors of a listed company should not be less than four or one third of the total number of directors. If a meeting is held without quorum then the chairman and the directors entail liability to pay fine of ten thousand rupees. 111 This amount of fine should be enhanced as the public money of investors is involved in the listed companies. Moreover, the meetings of the Board decide the fate of the investors. If the meetings are not held properly then the ultimate sufferers are the institutional investors who have invested their huge shareholdings in the company.

Section 197 of the Companies Ordinance 1984:-

Companies are not allowed to make contributions to any political party or any person for political purpose under section 197 of the Companies Ordinance 1984. A fine of ten thousand rupees may be imposed upon such a company and the director or the concerned officer may be subjected to imprisonment for two years or fine. This section does not prescribe the fixed amount of fine to be imposed upon the director or the officer making contravention. The competent authority is left at liberty to impose any fine. This section clearly provides protection to politicians. Such provisions of law require to be amended and no favor should be accorded to a particular group.

Section 197-A of the Companies Ordinance 1984:-

The company making gifts to its members in the meetings is liable to be proceeded against under section 197-A of the Ordinance. Penalty in the shape of fine of rupees five thousand may be imposed upon such a company or the officer concerned. In case of a listed company the amount of fine should be higher as compared to an unlisted company. The distribution of gifts in AGM or other meetings to the members of choice is clearly injurious to the healthy growth of capital market. It also interferes in the progress of sound corporate practices and culture.

Important things to improve institutional shareholder's activism:-

- There must be a supervisory board
- There must be a corporate strategy committee
- There could be a system that supports the negotiations with investee companies.

CONCLUSION

This study concludes that institutional investors are the change agents in the corporate government practices. In developed countries strict laws are devised to protect the investors. In developing countries like Pakistan only the institutional investors are the forces that have influence on managerial decision making. Legal environment is week and proxy voting is allowed and institutions can coordinate with each other here so the institutional investor is the only thing that solves the principle and agent problem.

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