Pakistan’s Environmental Social Governance Dimensions: Securing Access to Long-Term Capital

Since 2002 Pakistan’s apex corporate regulator started building the governance architecture for corporate enterprises in Pakistan. Following in the footsteps of infamous global governance failures of Bank of Credit and Commerce International, the United Kingdom’s mirror group, Enron and WorldCom, Pakistan was one of a handful of developing economies to author and adopt an indigenous code of corporate governance loosely based on the principles of the Organisation for Economic Co-operation and Development (OECD) and the UK’s Cadbury code. It was recognised by the leadership of the Securities Exchange Commission of Pakistan (SECP) at the time that there was enough evidence to indicate that well-governed companies with high principles of probity, transparency and accountability had share price stability and traded at premiums compared to firms that had weak corporate governance. These companies had long-term sustainable growth and therefore, were considered highly investable by pension funds and other big institutional investors. After early resistance of the code, the corporate mood quickly changed to an appreciation of how good governance can add to the long-term sustainable value of enterprises at a micro and macroeconomic level. The code is now an integral part of Pakistan’s regulatory framework and recognised as being a key pillar in the governance value addition of Pakistan’s corporate enterprises.

There is plenty of global research to suggest that companies which follow the best corporate governance practices like independent diverse boards, boards with majority independent non-executive directors who chair all the committees of the board, transparency and merit-based compensation for senior executives and gender equality, do deliver long-term value to all their stakeholders and are a valuable part of the economy.

Pakistan’s governance dimension was further reinforced after the 2008 global financial collapse. Once again, the SECP performed a recalibration of its code and further iterations were released. Capacity building efforts to reinforce the value creation attributes of good governance were delivered by dedicated institutions like the Pakistan Institute of Corporate Governance (PICG) supported by a mandate from the SECP for listed company directors to be trained and become its members.

Whilst much has been done to recognise the governance dimension in Pakistan and build the capacity of corporate leaders and regulators, much more investment must be done in the Environmental (E) and Social (S) dimensions which together present the most challenging existential headwinds facing nations and businesses globally. The social threats that businesses face in Pakistan can very easily fall into the global hashtags of ‘MeToo’ and ‘BlackLivesMatter.’ Starting from indigenous gender inequality, economic inequality, exclusion of ethnic minorities, slave and bonded labour, human rights violations, the list is long. On the E list, Pakistan can start with climate change (being the fifth most impacted country in the world according to the Global Climate Risk Index), air quality and the link with industrial emissions and transport, water scarcity for both industry and public, solid waste management especially plastics, construction industry methods and their carbon footprint and design.

These E and S existential threats are interconnected with the financial well-being of business enterprises from the investor angle in that providers of capital are no longer basing their investment decision solely
on financial Key Performance Indicators (KPIs). They are looking at the firm, sector, and country level ESG risk being faced in their target market for investment, things like how they are measuring and managing ESG in the short-, medium- and long-term. At the country level, if the human rights laws are weak, or environmental laws are weak they will be screened out of their investable portfolios.

The custodians of Pakistan’s capital markets the SECP, Pakistan Stock Exchange (PSX), State Bank of Pakistan (SBP) and Pakistan Reinsurance Company (PAKRE) must recognise:

1. the importance being given to the ESG dimensions globally
2. that capital flight risk and long-term investment opportunities loss will occur unless ESG risk management, monitoring, management, and capacity is improved
3. that global measurement and reporting standards are being developed and adopted.
4. that Pakistani enterprises are not voluntarily embracing these ESG reporting standards
5. document sector and firm level material ESG risks for Pakistan. Similar ESG screening will apply to funds from Multilateral and Bilateral Lending Agencies as well as to issue of sovereign debt such as Euro bonds and Sukus.

In light of the above background, this session will address the following questions:

1. Given the existential threat of climate change and social inequality, is the time right for Pakistan to bring in the Environmental and Social dimensions at parity with corporate governance at a regulatory level?
2. What is the likely impact of cost of borrowing for long-term capital projects if Pakistani enterprises both public and private ignore factoring in material ESG risks?
3. What is the nature of green financing and its benefits in reducing both carbon footprints and social harms? Why is the appetite of such financing so slow in Pakistan?
4. What is the SECP doing about keeping up to date with the changing megatrends (such as the movement away from independence and Non-Executive Directors (NEDs) to diversity and inclusion, to sustainability, equality especially in rewards, the difference between the salary of a CEO and C suite versus others, customer rights, especially data privacy?

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