Theory and Practice of Corporate Governance: An Analysis of the Agency Problems in Pakistan

Fatima Wahla[*]

Abstract

This article sheds light on the agency conflict among various stakeholders in the corporate system of Pakistan. Agency conflict is a major issue in corporate governance with regards to ownership and control. There are three main agency problems - conflict between shareholders and the management, between minority and majority shareholders, and between firms and the banks. The first one is the most prevalent in Pakistan. Since the shareholders provide seed to the economy, the Securities and Exchange Commission of Pakistan and the Pakistani courts have tried to secure their best interests. The agency conflict existing between the majority and minority shareholders is not a frequently discussed issue and due to the common concentrated ownership structure in Pakistan, it is highly improbable that such conflicts are heard in courts. The agency conflict between firms and banks is, however, not a common one, as the latter hold better protection; any money obtained from banks has to be returned.

Introduction

According to the 2017 annual report of the Securities and Exchange Commission of Pakistan ('SECP'), 8,286 new companies were registered in Pakistan. Compared to the preceding financial year, this signalled a growth of 34%, raising the total corporate portfolio to 80,700.[1] The continuous increase in the number of companies not only depicts economic growth and circulation of money, but also provides opportunity for the SECP to formulate new methods of handling and controlling companies. Albeit the fact that this annual report illustrates a reduced number of registered public limited companies, the focus of the SECP, nevertheless, remains on their regulation. The checks on public limited companies are higher because of the imbalance between the companies' capital and control; this imbalance forms the most frequently discussed agency problem in Pakistan.

An agency problem arises whenever the welfare of one party (the principal) depends on the actions taken by another (the agent).[2] The difficulty lies in motivating the agent to act in accordance with the principal's interest, rather than his own, as generally the agent has better information than the principal regarding the situation. It is therefore possible that, on the basis of those facts, he can act in a manner detrimental to the principal and beneficial to himself. The principal cannot always ensure that the agent acts in accordance with what was promised to him. Therefore, an agent has a fiduciary relationship with the principal, which means that the former must perform his duties with due skill, authority, in obedience, and in the interest of the principal, while avoiding the temptation of self-gain from the privileged position bestowed upon

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[*] B.A. LL.B (Hons) Lahore University of Management Sciences (LUMS).

[1] *Annual Report, 2017* (Securities and Exchange Commission Pakistan, 2017) 22 <https://www.secp.gov.pk/document/annual-report-2017/?wpdmdl=29755> accessed 5 January 2018.

[2] Reinier Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press 2017) 35.

him.[3] A lack of trust between the principal and the agent is ultimately detrimental to both the parties. In a conflict, the shareholders/principals will desire to maximise their value (increased share price and stable dividends) and the controllers/agents will attempt to make the most of their utility (survival and power). The difference in this process of maximising utility between the two parties is considered an agency cost.[4]

There are generally three recognised types of agency problems that arise in business firms.[5] The first is the conflict between the owners of the firms and their hired managers, the former being the principals and the latter the agents. The second agency problem involves a conflict between the majority shareholders/controlling owners and the minority shareholders/non-controlling owners; here, the controlling owners are the principals and the non-controlling ones are the managers. A conflict between the firm and the other parties with whom it contracts or interacts with is the third recognised type of agency problem. This conflict involves the creditors, employees, and the customers of the firm. The difficulty lies in assuring that the firm, as in the case of the agent, does not behave opportunistically towards its various other principals.

This article examines the system of corporate governance in Pakistan through the lens of the agency problems it faces. It discusses the aforementioned agency problems with the aid of reported case law. The article asserts that out of the three agency problems, the conflict between the shareholders and the directors of a company is the most widespread one in Pakistan with the SECP and the High Courts being inclined towards protecting the interests of the shareholders as they have provided investment to the firms. The second agency problem deals with the conflict between the majority and minority stakeholder, and is the least reported upon due to the concentrated ownership structure of firms in Pakistan. With regards to the third agency problem, banks have been supported by the SECP and the High Courts, specifically in terms of the non-payment of loans by the firms with case law demonstrating that the judiciary has generally tried to protect the interests of the investors. It is worth noting that the SECP has also played a significant role in regulating the agency problems in Pakistan.

The agency conflicts in Pakistan are assessed in the following three separate sections.

Section I: Conflict Between the Firm's Owners and its Hired Managers

This section focuses on the most common agency problem that exists in Pakistan and that is the one between shareholders and the managers of a company. Agency costs rise with the separation of ownership and control of the firm due to the difference in interests between shareholders and the managers.[6] The likely source of the conflict is the managerial tendency to expand the company, even at the stake of shareholders' interest. This expansion benefits the managers as their remuneration is linked to it. On the other hand, shareholders are focused on receiving

[3] Deborah DeMott, 'Shareholders as Principals', in Ian Ramsay (ed), *Key Developments in Corporate Law and Equity: Essays in Honour of Professor Harold Ford* (LexisNexis Butterworths 2002).
[4] Michael C Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1973) 3 (4) *Journal of Financial Economics* 313.
[5] Ibid.
[6] (n 4) 309.

dividends, instead of investing the profit in expansion activities carried out by the managers.[7] Managers also have incentives to retain cash, in part because the cash reserves increase their autonomy in the capital market. These reserves can also lead to the expansion of the company, and this is more important for the managers than maximising the wealth of the shareholders.[8] It is therefore evident that there is an existing conflict between the party providing the money and the party managing it. It will be seen in the case law mentioned below that the SECP and the courts are inclined towards preserving the rights of the shareholders, rather than favouring the directors.[9] There are two conceivable reasons for this. Firstly, as mentioned above, most companies in Pakistan have a concentrated ownership structure and are run by their majority shareholders.[10] Secondly, since Pakistan is a developing country, the SECP and the courts are keen to preserve the inflow of capital in the market and this can only be done by providing adequate protection to the shareholders. The following case law shows the prevalent conflicts and depicts the approach of the SECP and the courts in dealing with such issues.

In *Habib Ullah v Executive Director (Enforcement),*[11] the annual audited accounts of the company revealed that certain amounts had been advanced for the purchase of a property, which was to be used as a guest-house for the officials of the company. However, the guest-house was in fact in the personal use of the Chief Executive Officer ('CEO'). The company failed to provide any documents to demonstrate that its policy allowed the CEO to reside in the said property. Moreover, the property had not been transferred in the name of the company. The appellants argued that the transfer could not take place due to legal hurdles. The SECP ruled that the misstatements made in the annual audited accounts were in violation of the Companies Ordinance 1984, which outlined the 'penalty for false statement'.[12] It further ruled that the CEO had no right to utilize the company's resources for his personal use. This case clearly sets out the rule that, unless specifically allowed under the rules of the company, directors cannot exploit the resources of the company for their own personal use. The case of *Mian Shahzad Aslam v Commissioner, SECP*,[13] falls under the same provision[14] mentioned in *Habib Ullah.* Here, it was emphasised that the investors should be provided with correct and verified information on all the interim or annual accounts. The directors had tried to mislead both the SECP and shareholders, along with the creditors, by trying to pass off un-reviewed half-yearly accounts as reviewed ones. The SECP ruled that the excuse given by the directors as being negligent could not be accepted where there was such a deliberate effort to deceive a vital regulatory compliance requirement. The directors, in fact, demonstrated an unprofessional and irresponsible attitude by submitting false information and purporting it to be authentic.

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[7] Kevin J. Murphy, 'Corporate Performance and Managerial Remuneration' (1985) 7 (1-3) *Journal of Accounting and Economics*, 11-42.

[8] (n 4) 309.

[9] These cases are cited with reference to the Companies Ordinance 1984; however, the sections used in the case law can be compared to sections in the updated Companies Act 2017. Therefore, the respective sections of the Companies Act 2017 are mentioned along with the cases discussed.

[10] Attiya Y. Javaid and Robina Iqbal, 'Ownership Concentration, Corporate Governance and Firm Performance: Evidence from Pakistan' (2008) 47 (4) *The Pakistan Development Review* 643–659.

[11] 2013 CLD 1478 [SECP].

[12] The Companies Ordinance 1984, s. 492, and the Companies Act 2017, s. 496 (which discusses 'penalty for false statement, falsification, forgery, fraud, deception').

[13] 2013 CLD 287 [SECP].

[14] The Companies Ordinance 1984, s. 492 and the Companies Act 2017, s. 496.

In the case of *Fawad Ahmad Mukhtar v Director (Enforcement) SECP,*[15] it was held that the shareholders must be informed while making any advancements or loans.[16] An examination of the annual audited accounts of the company had revealed that the company had provided interest-free loans and advances of around PKR 10 million to various associated companies. This was done without passing a special resolution by the shareholders, as was required under section 196 of the Companies Ordinance 1984.[17] The company contended that all the investment was forwarded on the instructions of the sponsors. A show-cause notice was issued to appellants under section 208 of the Companies Ordinance 1984.[18] The SECP ruled that the advances made by the company to the associated companies could not have been done with the approval of the sponsors and the appellants were careless for making such investments in associated companies without complying with the requirements of section 208 of the Ordinance.

In the case of *Jahangir Elahi v Executive Director SECP,*[19] after examining the annual accounts of Taj Textile Mills Limited, it was observed that the short-term borrowings, including bank credits facilities of PKR 246 million, had been transferred by Elahi Enterprises (Pvt.) Ltd. to Taj Textile. It transpired that Elahi Enterprises had suffered a severe setback with respect to its business, so the board of directors of Taj Textile passed a resolution authorizing the Chief Executive to accept shifting of loan liabilities of Elahi Enterprises to Taj Textile. This act involved the common directors, who took part in the discussion and voted on the resolution. The SECP issued two show-cause notices for two different violations.[20] The first one was issued to the directors for violations of sections 195, 188, 189, and 208(1) of the Companies Ordinance 1984. The SECP ruled that the appellants who held common directorship on the board of directors of Taj and Elahi Enterprises, acted in their personal interest, and transferred the liability of the bank from Elahi Enterprises, a private limited company, to Taj Textile, a public limited company. This transfer was processed without adequate consideration, and had a detrimental effect on the shareholders of Taj Textile.

[15] 2013 CLD 1385 [SECP].

[16] Other cases which address similar issues under the Companies Act 2017, s. 199 are *Naseem Saigol v Executive Director SECP* 2013 CLD 1179 [SECP]; *Raza Kuli Khan Khattak v Executive Director SECP* 2013 CLD 220 [SECP]; and *Inayat Ullah Niazi v Executive Director, Enforcement SECP* 2013 CLD 1300 [SECP].

[17] The Companies Act, 2017, s. 183.

[18] The Companies Act 2017, s. 199 (Investments in associated companies and undertaking). In this Act the duty on directors has been increased while issuing loan to associated companies, as it requires that the directors of the investing company shall certify that the investment is made after due diligence, and financial health of the borrowing company is such that it has the ability to repay the loan as per the agreement.

[19] 2010 CLD 408 [SECP].

[20] A show cause notice was issued under the Companies Ordinance 1984, s. 188 which relates to the vacation of office by the directors; s. 189, which is about the penalty for unqualified person acting as director, etc.; s. 193 for the proceedings of directors; s. 208 for the investments in associated companies and undertaking; s. 214 for the disclosure of interest by director; s. 215 relating to the interest of other officers, etc.; s. 216 for the interested director to not participate or vote in proceedings of directors; and s. 217, which relates to declaring a director to be lacking fiduciary behaviour. With regards to the Companies Act 2017, this case falls under s. 171 for vacation of office by the directors; s. 175 for penalty for unqualified person acting as director; First Schedule, 54 for proceedings of directors; s. 199 for investments in associated companies and undertaking; s. 205 for disclosure of interest by director; s. 206 for interest of officers, etc.; s. 207 for interested director not to participate or vote in proceedings of board; and s. 212 for declaring a director to be lacking fiduciary behaviour.

In another case, *Hamid Textile Mills Limited,*[21] the company failed to hold its Annual General Meeting ('AGM') within the prescribed time and a show-cause notice sent under section 158 of the Companies Ordinance 1984[22] remained unanswered. The CEO contended that the company could not hold its AGM due to a change of management and the delay was caused by the annual audit of the financial year. The SECP thereon pointed out that the AGM was a forum where investors could freely discuss, speak, and vote on important matters, and therefore, it was unfortunate that the directors were not observing the compulsory requirements of law, thus demonstrating that the SECP was more inclined to protect the interests of the shareholders.

Analysis of the aforementioned case law affirms the fact that the SECP is careful in dealing with cases where the interests of shareholders are at stake. Even the non-submission of the quarterly reports and not holding the AGM is considered to be a serious matter. This approach is laudable, because it not only encourages investors, but also attracts foreign investment, which ultimately contributes in fostering the growth of Pakistan's economy.

Section II: Conflict Between Majority and Minority Shareholders

In a corporate scenario, there is always a possibility that the majority/controlling shareholders will extract personal benefits at the expense of the minority/non-controlling shareholders.[23] These benefits can include paying excessive compensation to themselves, empowering themselves to transfer resources, and electing board members.[24] This type of agency conflict can adversely impact the share price of a company.[25] The available literature and case law demonstrate that the conflict between the majority/controlling shareholders and the minority/non-controlling shareholders is the least discussed one in Pakistan. There can be several reasons for this. However, this paper argues that since large companies in Pakistan are family-owned,[26] and their functioning is considered a 'family affair', such disputes are rarely taken to the courts, and are mostly resolved privately.[27] The following decisions depict this trend and the type of conflicts which arise between the majority and the minority shareholders in Pakistan.

In *Zahur Ahmed v The Commissioner, SECP,*[28] a group of shareholders (belonging to the Zahur family) acquired a majority shareholding in a company through another company named Consolidated Overseas Investment and Finance ('COIF'). COIF was purportedly incorporated in Switzerland, but upon inquiry, the Swiss officials revealed that COIF was not registered in any commercial register of the country. The SECP ruled that the appellants were in violation of the Takeover Ordinance 2002, as they had deprived the shareholders of the company of their right to

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[21] 2010 CLD 69 [SECP].
[22] Companies Act 2017, s. 132 (Annual General Meeting).
[23] Tatiana Nenova, 'The Value of Corporate Voting Rights and Control: A Cross-Country Analysis' (2003) 68 (3) *Journal of Financial Economics* 325–351.
[24] Benjamin Maury and Anete Pajuste, 'Private Benefits of Control and Dual-Class Share Unifications' (2011) 32 (6) *Managerial and Decision Economics* <http://onlinelibrary.wiley.com/doi/10.1002/mde.1538/full> accessed 8 December 2017.
[25] Alexandre Di Miceli da Silveira and Armando L. Dias Junior, 'What Are the Costs of Conflicts between Controlling and Minority Shareholders in a Concentrated Ownership Environment?' (2008) *SSRN Electronic Journal* <https://ssrn.com/abstract=1019241> accessed 6 December 2017.
[26] (n 9).
[27] Ibid.
[28] 2016 CLD 2252 [SECP].

participate in the public offer, on change of control of the company. This decision is a clear example of the SECP acting to protect the interests of the minority shareholders. It is evident in this case that the tactic used by the majority group to pass the liabilities to another company was detrimental to the minority shareholders. Therefore, SECP decided in favour of the latter. Similarly, in *Suleman Lalani v Al-Abbass Sugar Mills Ltd.*,[29] the plaintiff approached the Sindh High Court for an injunctive order to restrain the defendant company and its directors from making investments or capital expenditure in the shares of another company, Javedan Corporation Limited ('JCL'). This case was heard by the court on an urgent basis, as the 39th board meeting was scheduled just a week after the 38th one, and the agenda included seeking approval for investment in JCL. The plaintiff claimed to represent the minority shareholders of the defendant and argued that the defendant directors of the company had more than 20% shareholding in JCL, which made it an associated company. Minority shareholders contended that JCL was already suffering losses and that the defendant directors were indirectly trying to secure their losses in JCL by proposing an investment by the defendant company. It was argued that the defendant directors were planning to invest in the associated company for their own personal benefit after getting approval of the board of directors which, in turn, would result in the losses for the minority shareholders. The court ordered that the company was free to hold its 39th meeting of the board of directors, and could take any decision for the benefit of the company. However, the defendants were restrained from making any decision regarding the investment in JCL. Therefore, the majority shareholders were prohibited from acting in a manner that could possibly disadvantage the minority shareholders.

The two cases detailed above show that the court acknowledged the value of minority shareholders and protected them from the injustice of the majority shareholders. This, however, is not always the stance and the courts look into the facts of the case in order to determine whether an allegation of oppression of the minority shareholders is justified or not. The following case law depicts that after considering the factual circumstances of the case, the court did not favour the minority shareholders. In *Muhammad Kamran Nadeem v Webcom (Pvt.) Limited*,[30] the minority shareholders, holding 30% of the shares, sought winding up of Webcom because of their dissatisfaction with some of the decisions taken by the majority shareholders.[31] The Islamabad High Court ruled that the allegations raised in the petition were not supported by any material that was placed on record. It further held that the minority shareholders may have disagreed with some of the decisions of the majority shareholders, however, the same did not result in oppression. The onus was on the minority shareholders to form a case for a winding up order; which they failed to fulfil.[32]

In *Pak Water Bottles (Pvt.) Limited,*[33] three petitioner companies sought a merger and filed an application under sections 284 and 287 of the Companies Ordinance 1984. It was claimed that the benefit from the merger would be an increase in profitability, after the removal of overlaps in management, marketing, and distribution expenses. It was further stated that the

[29] 2014 CLD 52 [Karachi].
[30] 2016 CLD 1277 [Islamabad].
[31] The former brought the case on the basis of the Companies Ordinance 1982, s. 305, which empowered the court to supervise the winding up of a company or to lay down terms and conditions upon which winding up is to occur.
[32] The Companies Act 2017, s. 381 (Power to order winding up subject to supervision).
[33] 2003 CLD 1634 [Lahore].

petitioners had obtained the written consent of more than 90% of the creditors of all three companies, and henceforth sought approval for the scheme of arrangement. A minority shareholder of one of the companies objected on the grounds that two of the companies were operating on a profit and the surviving company was already a majority shareholder in the first two ones. It was alleged that the board of directors of these two companies, without the knowledge of the objector, entered into an arrangement with the board of directors of the surviving company. Lastly, it was stated that the merger was solely benefiting the surviving company and the proposed swap ratio had no nexus with the actual worth of the two companies. The court ruled that the owner of the two companies, who controlled 90% of the shares in them, enjoyed a privilege under the law to dominate the boards through its nominees and that "it would also be unnatural and rather illogical to think that these nominees would act in a manner which is prejudicial to the interest of the principal company."[34] The relevant provisions of law contained in sections 284, 285, and 287 of the Companies Ordinance 1984 concede a democratic right to 3/4th majority of the members of a company to make a choice, which the minority is obliged to accept. The objector in this case had a very small stake in the company, and the disapproval of the scheme, or a direction to reconsider the swap ratio, was not likely to improve the status of the objector. Consequently, the court did not find the scheme to be unfair, unjust or oppressive to the minority, as had been alleged by the objector.[35]

In *Kohinoor Raiwind Mills Ltd.,*[36] three companies had been declined approval for a scheme of merger, and had preferred an intra-court appeal to a Division Bench of the Lahore High Court. Through the merger, two of the companies were to be dissolved without winding up and the surviving company was to issue fully paid-up shares to the shareholders of the dissolved companies. Serious objections were filed by the SECP before the judge with regards to the swap ratio in the proposed scheme of arrangement. The SECP acted on the reservations it received from certain shareholders. The objection of the SECP to the swap ratio was material as it alleged that the proposed merger was against the interests of the shareholders of one of the companies being dissolved. It was further stated that the swap ratio was calculated unfairly to the disadvantage of shareholders, as one of the companies was a profit-making one, while the other was included in the defaulters' list of the Karachi Stock Exchange. The judge accepted the objections to the swap ratio and declined sanctions against the proposed arrangement of merger of the appellant companies. In an Intra-Court Appeal,[37] the appellants produced a revised swap ratio in which the shares of the dissolving company, initially allocated in the surviving company, were increased, but the objections of minority shareholders remained unsatisfied. The court held that the objecting shareholders (minority), who were to suffer a loss as a result of their shares

[34] Ibid, 1653.
[35] Under the Companies Ordinance 1984, s. 284 relates to power to compromise with creditors and members, s. 285 elaborates on the power of the court to enforce compromises and arrangements, s. 286 discusses information in relation to compromises or arrangements with creditors and members, and s. 287 outlines provisions for facilitating reconstruction and amalgamation of companies. Under the Companies Act 2017, this case falls under s. 279, 280, 281 and 282, which discuss compromise with creditors and members; power of the commission to enforce compromises and arrangements; information as to compromises or arrangements with creditors and members; and powers of the commission to facilitate reconstruction or amalgamation of companies respectively.
[36] CLD 2002 1747 [Lahore].
[37] This case falls under sections 284 and 287 of the Companies Ordinance 1984, which discuss power to compromise with creditors and members, and provisions for facilitating reconstruction and amalgamation of companies; in the Companies Act 2017, sections 279 and 282 discuss compromise with creditors and members, and powers of the commission to facilitate reconstruction or amalgamation of companies respectively.

being valued less, would not gain any profit, as they did not have any vested interest in the surviving company. This case depicts that, where the merger seems to disadvantage the minority shareholders, the court intervenes to protect their interests. However, in *Pfizer Laboratories Limited v Parke Davis & Company Limited*,[38] where the minority shareholders did not suffer due to a proposed merger, the court did not pay heed to their objections.

In *Razzak Usman v Golden Plastics*,[39] an application for the prevention of mismanagement and oppression was brought under section 290 of the Companies Ordinance 1984.[40] The petitioners in this case were minority shareholders, while the respondents were the majority ones. It was alleged that the majority shareholders were actually running the company and the petitioners were not given due regard in the general meetings or in the running of affairs of the company. The court, upon consideration of the circumstances, ruled that it was just and equitable to order the winding up of the company. These circumstances included a deadlock between the parties, a complete lack of confidence between the minority shareholders and the majority shareholders, the low value of shares, continuous losses suffered by the company, and the absence of all the shareholders in the present proceedings. Several other cases were cited in the judgment, wherein, due to the increased and seemingly insurmountable tensions between minority and majority shareholders, the courts ordered the winding up of the company.

The tension between the minority and majority shareholders is not a widely discussed aspect in the reported judgments, though the above mentioned case law suggests that the courts are inclined towards securing the interests of the minority shareholders. However, due to a fewer number of reported cases on this subject matter, a holistic view of this problem in the corporate sector of Pakistan cannot be deduced.

Section III: Conflict Between the Firm and its Creditors

This part focuses on the relationship between firms and their main creditors (banks in the context of Pakistan). Banks provide loans to firms or shareholders for investing, and form the backbone of the Pakistani corporate structure. Special banking courts have been constituted under the Financial Institutions (Recovery of Finance) Ordinance (XLVI of 2001) to deal with disputes arising between banks and their customers; these include, but are not limited to, the provision and recovery of finances.

Chrisostomos Florackis has reported that bank debt is an effective monitoring device to lessen agency cost in UK firms. Managerial ownership, ownership concentration and to some extent bank debt, all function as corporate governance mechanisms or devices for UK's firms.[41] According to him, the announcement of a bank credit agreement conveys positive signals about a borrower's credit worthiness, and consequently decreases the asymmetric information between

[38] 2007 CLD 1047 [Karachi].
[39] 1998 CLC 1109 [Karachi].
[40] This case was brought under Part X (Prevention of Oppression and Mismanagement) of the Companies Ordinance 1984, specifically s. 290 (Application to Court); however, it will fall under the Companies Act 2017, s. 286 (Information as to compromises or arrangements with creditors and members).
[41] Chrisostomos Florackis, 'Agency Costs and Corporate Governance Mechanisms: Evidence for UK Firms' (2008) 4 (1) *International Journal of Managerial Finance* 41<https://doi.org/10.1108/17439130810837375> accessed 4 December 2017.

borrowers and investors.[42] Another report also found that agency costs decrease when firms are subjected to greater monitoring by their banks.[43] It is argued that banks generally require a firm's managers to report results honestly and to run the business efficiently, and that bank monitoring complements shareholders' monitoring of the managers, which indirectly reduces owner-manager agency costs. Thus, by incurring monitoring costs to safeguard their loans, banks lead firms to operate more efficiently.

The subsequent literature depicts that in the case of a creditor (bank) and the firm, the agency cost is relatively low as compared to the agency cost incurred in conflicts between directors and shareholders and those between minority and majority shareholders. However, case law suggests that the agency cost is not completely eliminated and the courts have a tendency to support the creditors in case of a conflict.

In *Habib Metropolitan Bank Limited v Subhan Knitwear*,[44] the defendant availed a number of financial facilities but eventually defaulted. The defendant claimed that the amount shown on the documents by the bank was exaggerated and also denied having availed some of the facilities. The court relied on the extensive documentary evidence provided by the bank and this did not support the statement of the defendant. Similarly, in *Allied Bank Limited v Maqbool Usman Fibres*,[45] the defendant failed to repay the borrowed amount in the time and manner agreed between the parties. The court ruled that the defendant failed to raise any substantial question of fact and thus decreed in favor of the plaintiff. Both these cases depict that until and unless there is an actual controversy of facts, the debtor has to pay back the creditor.

In *Bank of Punjab v Messrs Sultan Motors*,[46] an appeal was filed by the bank regarding the failure of the banking court to grant markup, to which the bank was entitled as a decree holder. The banking court granted markup till the date of default of the defendant, while the bank requested it to be granted till the validity of the agreement. The High Court allowed the appeal and granted the amount of outstanding markup to the bank. This shows that not only the original amount, but also the markup is provided to the bank if a party defaults.

In *Muhammad Yaqoob Sheikh v Election Tribunal (Multan Bench)*,[47] nomination papers were rejected by the election tribunal on the ground that the petitioner had concealed material facts from the returning officer and was, in fact, a defaulter. The petitioner contended that he had not taken any loan in his personal capacity, even though he was a majority shareholder of a defaulting company. In the present case, lifting the veil of incorporation revealed that the petitioner was a majority shareholder in the company. Therefore, for the purposes of Article 63(1)(n) of the Constitution of Pakistan,[48] the loan obtained by the company was considered to

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[42] Ibid.
[43] James S. Ang, Rebel A. Cole and James W. Lin, 'Agency Costs and Ownership Structure' (2000) 55 (1) *Journal of Finance* 10 <https://ssrn.com/abstract=981268> accessed 19 November 2017.
[44] 2017 CLD 298 [Lahore].
[45] 2017 CLD 1115 [Lahore].
[46] 2017 CLD 923 [Lahore].
[47] 2013 CLC 1512 [Lahore].
[48] This provision includes a loan obtained by a candidate or his business or by a corporate entity in which the candidate holds majority shareholding, which establishes his control and management over the said business of the corporate entity.

be one that was obtained by the petitioner. This case portrays that protecting investment by banks is so important that even a majority shareholder of a defaulting company will not be allowed to participate as a candidate in an election.

In *Mussaid Hanif, Chief Executive v Head of Department (Enforcement) SECP,*[49] the board of a company proposed cash dividends for a year and this was put forward at the AGM for approval from the shareholders. The Bank of Punjab, one of the creditors of the company, communicated its reservations to the SECP as the company had an agreement with the bank which prevented it from paying dividends without its prior approval. Therefore, the bank succeeded in obtaining a stay order against the payment of dividends by the company. The company clarified to the Commission that it had issued the dividends only to the minority shareholders, and the bank subsequently sued for breach of contract. The Commission imposed a fine under section 492 of the Companies Ordinance 1984. The Company argued that *mens rea* was a necessary ingredient of offence under the above mentioned section[50] and needed to be established before the imposition of a penalty. The SECP was not convinced that the directors should be absolved from their responsibility to the shareholders, as they surrendered their right to receive a dividend. Therefore, it was held that it was incumbent upon the directors to have fully disclosed the restriction on the right to receive dividend in the accounts; thus, the reservations of the bank were duly considered by the court.

The cases discussed above represent the approach of the Pakistani courts and the SECP while dealing with investment (in the form of loans) taken by the firms. It shows that the interests of the banks are important as they provide capital to the firms, which results in benefits, not only for the shareholders and the directors but also for the employees of the company and its various other stakeholders.

Conclusion

This article has examined the existence of the agency conflict and its types in the corporate system of Pakistan. After analysing the available literature and case law, it is proposed that the agency problem between shareholders and directors is the most common type brought before the SECP and the courts. The SECP and the courts have tried to preserve the interest of the shareholders in such cases in order to protect the investment in firms. Issues such as poor maintenance of accounts, unofficial use of company's resources, non-arrangement of an annual general meeting, non-reporting of quarterly accounts, allocating money without permission from shareholders, and all other practices which directly or indirectly affect shareholders' interest have been raised before the SECP and the courts, and both have tended to preserve the shareholder's interest as much as possible.

The second type of conflict, which is the least reported one, is between the minority and the majority shareholders. It can be speculated that this is due to the concentrated ownership structure of companies in Pakistan. Although the SECP and the courts appear to favor minority shareholders in most cases, the low number of reported cases makes it difficult to draw a firm conclusion on this point.

[49] 2015 CLD 491 [SECP].
[50] The Companies Ordinance 1984, s. 492; the Companies Act 2017, s. 496.

The third type of agency problem focuses on the relationship between the firms and the banks. Available literature shows that the agency problem is minimal in this type of conflict and since banks are a source of large investments, the courts are inclined to protect them in most cases.