

Investigative Process as Check on the Corporate Mismanagement

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Abstract: *A lot of changes have been made in all departments of Pakistan as well as at the worldwide level, and such changes were necessary to be made for the smooth growth of departments and development of countries which ensured not only a good and trustworthy atmosphere but also improved the financial status of many countries. All these changes and developments were possible only with the participation of some developed countries. This article discusses the different aspects of management of the company, which should act in a crystal-clear manner for the benefit of the shareholders. However, when the shareholders are of the view that the management is not functioning according to law to fulfil their aspirations, they can resort to remedies, one of them being investigation. Well organized work can only be guaranteed by preventing monopolies and mismanagement from corporate sectors. It also highlights that how the investigation should be conducted by remaining in possible subsequent sources of corporate management.*

Key Words: Investigative Process, Regulate, Corporate, Mismanagement, Company

Introduction

A corporate investigation is a process that deals with matters concerning business finance, regulations of business, misconduct of any employee, corruption, wrongdoings committed by any person, legitimacy of the business, and embezzlement etc. The business environment at a worldwide level is changing and has increased the expectations not only in Asia but also in European countries. While talking about the investigation process against the mismanagement of corporate sectors, it has been reported in the year 2014, 64% of large companies in the United States received profits of more than \$1 billion of US dollar, and almost 2/3rd of the companies in the US have to face different types of investigation such as insurance, financial management, energy etc. Sometimes, the services of advocates are taken, and experienced lawyers are engaged to settle down the matters and supervise the investigations in case of any transgression and misconduct.

A fair and good corporate investigation can enable the authorities to make fair and authentic decisions to avoid any future conflicts and violations which may relate to financial fraud and mal-practices of employees. It is also not out of place to mention here that the procedures of investigation should be defined very clearly, which

will provide an open space for the companies to work on a variety of investigation processes.

Particularly the absence or lack of literature on the said topic is the main factor for such corporate mismanagement, which can be improved to provide benefits to the corporate sector subject to the conditions that if responsibilities are handed over to the employees equally and justified. The reality of internal corporate structure has changed from democratic to bureaucratic ([Abraham Chayes, 1959](#)). The businessmen desire to enhance the rational and skills of their corporate sector's employees ([A. A. Berle Jr., 1960](#)). Finding out an accurate story of a corporate investigation can be a daunting task. The viewpoint behind the investigation is to determine discipline, guilt/innocence and also determine either a corporate entity faces exposure or not. It also provides a mechanism to improve future violations. The purpose of the investigation is to discover the criminal or civil consequences of a wrongdoer.

Each investigation is different and different methods should be adapted, such as judgments and common sense according to its nature. The Companies' Ordinance 1913 promulgated with amendments, but further amendments can be

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made in it regarding the investigation. Capacity building is imperative to make the investigative process successful. Absence of capacity building this mechanism is not successful. The investigative process provided by law it can never be used. However, section 100 of the British Companies Act, 1862, was never used practically. In short, there is an intense need to make improvements by amending the law to make the investigative process successful.

Management of the company should act in a crystal clear manner for the benefit of the shareholders. However, when the shareholders are of the view that the management is not functioning according to law to fulfil their aspirations, they can resort to remedies, one of them being investigation. The literal meaning of Investigation and affairs of investigation is that all the matters which are relating to the company's business, such as the profits of company, loss of the company, assets of the company and even the goodwill, agreements and internal or external transactions, capital of the company and such like other property's interest and control of all affairs of companies. The Laws relating to Companies in most countries recognize the necessity of administrative supervision and investigation to serve as a potential deterrent against mismanagement and at the same time an effective safeguard for minority shareholders.

National and individual savings establish the main foundation of principal investment in the country, which are important factors for the financial growth of the corporate sector ([Avtar Singh, 2018](#)). The 'Efficient functioning' can be guaranteed by preventing corporate mismanagement from undermining the interest of shareholders. A suitable working and performance of corporate officers can enhance not only the capital of companies but also can cause to give a good name to the company. These efforts of the officers of corporate sectors will secure the companies as well as the jobs of employees itself who has caused a reason for such a good capital of a company and its reputation as well ([Louis Loss, 1970](#)). The reality of internal corporate structure has changed from democratic to bureaucratic ([Abraham Chayes, 1959](#)). Finding out an accurate story of a corporate investigation can be a daunting task.

Research Objectives

The investigative process regulates the corporate management and high light the problems being faced by the management. The main aim of this article is to highlight the mismanagement in the corporate sector, which is causing for fall down of the companies and countries and other objects of

the article is to discuss the investigative processes being adopted in the corporate sector for the purpose of management and its control. Efforts at the world level have been made for making new laws to avoid economic insecurity in society. However, sometimes some flaws in-laws or some other shortcomings create obstacles for good and positive results in the corporate sector. So, keeping in view the said problems of the corporate sector, the research highlights the main regions that need to be a focus on by using the constructed objectives. The main objectives of the research article are to examine the current theoretical as well as practical aspects, including a legal aspect of the supervisory powers of the corporate management, to examine the practicalities, justify the legal status of the corporate management and appoint the appropriate officers for an independent investigation.

Research Question

The study has answered the question of what are factors that cause mismanagement or wrongdoings in corporate management.

Research Methodology

This section explains and focuses on the methodology, the research objectives that have been achieved through this methodology. The research methodology ensures and clarifies that the data which has been obtained for the purpose of research covers the correct region of the research process. The research methodology used for research is qualitative, and both primary sources such as Statues, Rules, Policies etc.), and secondary sources such as books, journals, websites and newspapers etc., have been used, which are appropriate for this type of research.

Scope of Study

The research study is vital because it is limited to the topic of the investigation process of corporate mismanagement. Only a brief concept of corporate mismanagement has been given, and specific aspects of corporate mismanagement have been discussed in this article.

Results

The results are taken out from this study answer fully to the research objectives and research questions along with the reasons that investigation in corporate management is the most important factor which not only ensures the fairness of process but also secures benefits of the shareholders of a company who exercise all functions of the company. It is also noticeable that sometimes the investigation misleads the officers

of management. The results also show that the Companies Ordinance, 1913 requires to be modified for introducing new investigation processes, which can be helpful for the management.

Chronological Explanation

It is important to start the investigation internally because the companies are more aware of the misconduct and violations of the employees, and they are more competent to sort out the matter and make decisions speedily. The Companies may observe that at the time of the audit, how many illegalities have been committed by the auditor and who would have supported or facilitated the auditor to commit such financial corruption. This process of investigation needs finance to be spent on the investigation process. The main focus of the investigation team is to observe the nature of the allegation, who has committed this misconduct, the financial loss to the company and possibilities for receiving the credit from alleged persons.

In Pakistan, corporate law was based on 'Joint Stock Companies Act, 1956'. It was the erstwhile Act that gave the inspiration of Companies' Ordinance 1984, which we have today. Companies' Ordinance provides investigative process into the affairs of corporate sectors. Then Security and Exchange Commission of Pakistan (SECP) provided a process for investigation. The question is whether the investigative mechanism provided both by the Ordinance and Security and Exchange Commission of Pakistan (SECP) is successful or not? According to Laissez-Faire theory state has to perform only two functions, such as defense of the state and maintenance of law and order. In this way, the state should prevent mismanagement through investigation while performing its functions of maintenance of law and order. The application for investigation should be made under section 263 (Companies Ordinance 1984) and rules 18, 28, 30, 32, 34 (Companies Rules 1985) and should be compliance with the relevant provisions of Ordinance. It is mentioned in the Companies Ordinance and Companies Act 2017, that every company is bound to engage/appoint legal experts and legal advisors for their companies to avoid any future mismanagement, illegalities or clashes.

Philosophy behind Investigation

Philosophy behind investigation is to determine discipline, guilt/innocence and also determine either corporate entity faces exposure or not. It also provides mechanism to improve future

violations. The purpose of investigation is to discover criminal or civil consequences of wrongdoer. There are some undercover investigations which an investigator observes through the conduct of the employee which includes theft, harassment or abuse of language. In research investigation, the investigators investigate the companies for joint venture, capital venture, acquisitions, mergers and investments etc. If any embezzlement occurs in any Company then the Company can discover the financial loss, fraud and money laundering through financial investigation. Now, it is very easy to investigate the matters electronically and the data collected through electronic investigation, can be used for evidence purposes which is very strong evidence and can be more fruitful for the Company and company calls it as E-discovery or electronic investigation. Sometimes, in government department, corruption is found where the investigators examines the nature of corruption and then unveils the illegal actions of the employee, bribery if taken by any employee and any fraud regarding corporate etc., this is named as corruption investigation.

Powers of Investigation

The public opinion is true investigation process for the matters relating to corporate sector so it is necessary that the powers of investigation should be organized, supervised and exercised by governmental departments very carefully ([O. K Freund, 1946](#)). The Corporate Supervision Department of Securities and Exchange Commission of Pakistan (SECP) issued 38 show cause notice to company directors and officers for violation of statutory provisions ([Dawn News, 2016](#)). Investigative process is different in different countries.

Investigation into Affairs of Company

Both Courts and Security and Exchange Commission of Pakistan (SECP) have powers to interrogate into domestic management of incorporation. Hence, courts would not interfere when a company is running its business fairly, according to law; while, Security and Exchange Commission of Pakistan has suo motu power to conduct inquiry into any internal matter of company under section 29 of Securities and Exchange Commission of Pakistan Act, 1997. Interest of minority shareholder must be protected. All resolution are passed by simple majority or by three-fourth majority, consequently, it is majority who takes decisions of company. It is general rule that majority decisions must be followed; this rule was settled in Foss VS Harbottle case under section 496 (Pakistan Companies Ordinance 1984). There must be

balance between interests of minority and majority because of prevalence of justice and fair play. Doctrine of Ultra Vires and Doctrine of Indoor Management are exceptions to general rule.

Section 496 of Pakistan Companies Ordinance 1984 defines the duties and responsibilities of director of company and in case if he acts in ultra vires of law and carries out any illegal business then he is also entitled for punishment or fine as per requirement of law not exceeding five thousand rupees. The director is also bound to fulfill the responsibilities arising out of such business (CLD 2003). It shows that law also required a balancing sheet between interests of majority and minority as well. In Pakistan, [the Companies Ordinance, 1984](#) under section 263 to 282 provides for the investigation of the business of company. The power is divided into two groups:

(A) Mandatory Provision

Section 265 (a) of the Companies Ordinance, 1984 narrates that where a company by a resolution in general meeting demands an investigation and the court can make an order relating to the affairs of the company as well as it can also force the company for facilitate the person who has been appointed as inspector by the commission of the company for conducting investigation and observing all the disputed matters among shareholders of company.

(B) Directive or Permissive Provisions

Such provisions are found in section 263 and section 265(b) such as on the application of members, the registrar submits report by taking opinion of Commission. In *Engro, chemical Limited VS Muhammad Hussain Dawood* (Company Case, 1980), the court held that the investigation into the affairs of the company can only be made by Security and Exchange Commission of Pakistan (SECP), only at motion of certain percentage of members of company or on report of registrar of companies. This jurisdiction cannot be invoked by outsiders.

Procedures to Control the Mal-Administration of Shareholders

Well-organized functioning can only be ensured, on satisfactory return of capital to shareholders, which is the best protection for individuals who provide investment. Investors are the backbone of incorporation, however there must be fair dealings on part of company's internal and external matters. Nevertheless, obvious mechanism for controlling deceit shareholder is inevitable, for organized functioning of incorporation.

Power of Inspector Pakistan Perspective

Under section 267 of Companies Act, it is very much clear that if the inspector of a commission thinks necessary for the purpose of his interrogation, can look into the affairs of company with prior approval of commission, (a) any other body corporate which is associated, holding, or subsidiary of company, (b) Any other body corporate whose chief executive is or was at the relevant time, the chief executive of the company.

The Company Judge forwarded the matter to the Security and Exchange Commission of Pakistan (SECP) for appointment of an honest and impartial inspector within 14 days of this order and he is bound to interrogate the contentions of the parties against each other, and then the inspector must submit report within two months. Section 266 of companies ordinance 1984 provides that inspector has the same powers as are vested to the civil courts under the Code of Civil Procedure, 1908, for the purposes of interrogation such as (a) ensuring the attendance of persons and examining them on oath affirmation; (b) to compel for the production of books, papers and any material objects; (c) issuing commission for the examination of witness.

Inspector's Report and Prosecution

Under section 269 of Companies Act, the inspector on the conclusion of investigation will make a final report to the commission. He will also make interim report to the commission, is so directed by the commission, section 270 provides that if on the submission of report, it appears to commission that, any person is guilty of any offence for which he is criminally liable; the commission may prosecute such person for the offence. Such offence shall be tried by the court established by law (CLD 2002, 1366).

Evidentiary Value of Inspector's Report

Section 278 of Companies Act, provides that, the report of inspector will be admissible in any legal proceeding as evidence. In *Messers General Tyre and Rubber Company of Pakistan Ltd VS Bibojee Services Pvt. Ltd* (sec. 256, Companies Act, 2017). it was held that, even after withdrawal of complaints the report which has now been finalized had prima facie value of evidence under law. Commission had power to take cognizance of the irregularity or contravention pointed therein independent of any complaint.

Updated Rules Regarding Investigation

Where commission deems fit to investigate any of the matters of the company or corporate sector it becomes necessary to investigate that matter.

Investigation can be started on the application of member having not less than 1/10 Of overall voting power but it is necessary to have share capital, section 256 of the Companies Act, 2017. It may be conducted on the application of member having not less than 1/10, total voting power but it's not necessary to have share capital. When commission thinks fit that investigation is necessary any of the matters of company. He will appoint one or more persons after receiving applications from members. It is mandatory that commission will give a chance to company of being heard before making a command because its company's legal right of being heard for any allegation. The commission obliges the applicants for expenditures of investigation before appointment of inspector. Contrary to section 256 (Companies Act, 2017), the investigation into corporate sectors may also be conducted on order of court. When any court passes an order and declares that it is necessary to investigate any of matters of the company because of its fraudulent activities, monopolies or insolvency. The inspector must be amongst the officers of commission or a professional having knowledge of ability, accounts, tax matters, accountability, capital and information of law, rules and regulation. He must be expert of having knowledge of all fields. Where there are no express provisions are provided in Companies Act, 2017, then the provisions of criminal procedural code shall apply.

Expenses of Investigation

The interrogation expenses are beared by the person who desires to get the matter interrogated by commission or inspector. The amount of expenses being paid by the parties is reimbursed according to this section and companies, body corporate or person are responsible for this payment of expenses as an arrear of land revenue under section 277(2) (Companies Act, 2017).

Conclusion and Recommendations

The political group in our country has great influence and interfere within the interrogation processes of corporate sector, due to this undue interference of these groups, the corporate sector cannot perform properly which causes economic destruction in the country. Therefore, it is compulsory that the corporate sector should be free from all sides so that the corporate sector may give better results to flourish the country' revenue and this is possible only when full liberty

will be given to corporate management. To give administrative powers to the officers are the requirement of this sector. No doubt, independence is important but it can not interfere in the accountability process.

Investigation, as it is self-evident, is one of the tools for the shareholders of the company to exercise control over the affairs of the company. It provides mechanism to the qualified minority as well as others to make the management and to run the affairs of the company lawfully, for the benefit of the shareholders. Although, it brings transparency in the corporate management, however, it must of the corporation, which is desired by none. The consequences which flow from the investigation usually distort the management and smack the credibility of those in control. So it is tool to be used carefully for the benefit of the shareholder.

As discussed above that the companies should appoint legal experts and legal advisors for the companies to investigate the misconduct and mismanagement of any employee but some companies are still violating these provisions of the said law and this is the reason that thousands of cases are pending in courts and are facing in civil litigations which not only is causing a huge financial loss for the companies but also effecting the revenue of country. The benefit to conduct the investigation through an expert will be that the company can save its finance as well as time rather to involve itself in civil litigation.

As every sector, company or legal entity has different issues which are settled in their own ways and each dispute is different in nature because of their dealings and policies with other sectors. Therefore, the corporate management should settle their own policies according to their matters rather to follow the policies of some other sector and investigation process should be done in different way i.e., by use of different methods, judgments and common sense according to the nature of dispute. The Companies Ordinance, 1913 promulgated with amendments and further amendments regarding investigation can be incorporated in the Companies Ordinance. The capacity building is imperative to make the investigative process more successful; due to the absence of capacity building, this mechanism is going unsuccessful. The investigative process provided by law, can never be used. In short there is needed to make improvements by amending law to make investigative process successful.

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