**DEPARTMENT OF MANAGEMENT**

**TERM PAPER**

**OF**

**CORPORATE GOVERNANCE AND BUSINESS ETHICS**

**ON**

**TO ANALYZE INVESTOR PROTECTION STRATEGIES PRACTISED IN DIFFERENT COUNTRIES AND THE WORTH OF EACH STRATEGIES AND THE BEST STRATEGY AMONG THEM.**

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# INVESTOR PROTECTION STRATEGIES PRACTISED IN CHINA

## Shareholders rights

• Granting shareholders the right to make motions, learn the truth, convene and preside over shareholders’ meetings and bring a derivative suit or direct suit against directors, supervisors and senior management

• Allowing a cumulative voting system in electing directors and supervisors, the general shareholders’ meeting of a joint stock company may adopt a cumulative voting system in electing directors and supervisors in accordance with a company’s articles of association or shareholders’ meeting resolution

• Enlarging the scope of information disclosure to shareholders – companies are now required to disclose the following information to shareholders: articles of association, minutes of shareholders’ meetings, resolutions adopted by the board of directors and the supervisory board, financial reports, and the accounting books

## Board and Company

• Increasing the functions and powers of the supervisory board

• Limiting the powers of board chairmen by abolishing chairman’s rights to exercise some of the powers of the board of directors during the period when the board is not in session. Abolishing the right of the chairman to designate a substitute chairman in the event he/she cannot perform duties

• Clarifying functions of convening and presiding over board meetings and voting rights of board members.

## Financial disclosure

• Requiring a limited liability company (LLC) to have its financial and accounting reports audited by an accounting firm (requirement previously limited only to joint stock companies)

• Stipulating terms of engagement and dismissal of the external auditor

• Establishing procedures for entering into related-party transactions – a resolution approved in the shareholders’ meeting is required before a company can provide security to a shareholder or to the actual controlling person/entity. Under the new procedures, the relevant shareholders or the shareholders controlled by the actual controlling person cannot participate in voting with respect to related matters. Such resolutions must be passed by a majority of the votes held by other shareholders present in the meeting.

## Financial Transparency and Accounting Standards

Ministry of Finance (MOF), government of china had issued 38 specific Basic Accounting Standards for Business Enterprises (ASBE) that are effective and applied to all listed Chinese companies. The new ASBE standards have brought Chinese accounting practices largely in line with International Financial Reporting Standards (IFRS), with some exceptions.

## Auditing

Revisions to the Company Law now require that, in addition to joint stock companies, LLCs must also have their financials and accounting reports audited. The law also clarifies conditions for engagement and dismissal of the external auditor. As described above, efforts are also underway to bring China’s accounting practices in line with internationally recognized standards.

## Audit Committee

The main duties of an audit committee are to recommend the engagement or replacement of external auditors, to review the internal audit system, to oversee the interaction between the internal and external auditors, to inspect the company’s financial information and its disclosure, and to monitor the company’s internal control system. Companies are required by accounting law to set up a sound internal control system.

## Regulatory Environment

The CSRC, as a centralized supervisory agency of securities markets, is responsible for promulgating regulations/ rules concerning regulation of the securities market and monitoring companies’ compliance with relevant regulations.

# WORTH OF THE ABOVE STRATEGIES:

* Valid internal governance system. Compared with state-owned stockholder, artificial person stockholder plays a more active role in a company’s internal governance. So, few artificial person stockholders will pursue short-term investment interests in the market. Artificial person stockholder will actively take part in the decision making of the board of directors. In the artificial person oriented governance pattern, artificial person stockholder could directly control a company’s operation through the board of directors.
* Corporate control exists in market.
* China has become a pre-market economy country.
* Corporate governance in China results from the interaction of many elements. The nature of China’s economic reform and the diversification trend of the ownership of Chinese enterprises make patterns of corporate governance in China different from what is popular in the world.

# Best strategy among above strategies:

The best strategy which China follows is the share holder’s rights. They are granting shareholders the right to make motions, learn the truth, convene and preside over shareholders’ meetings and bring a derivative suit or direct suit against directors, supervisors and senior management. China allows a cumulative voting system in electing directors and supervisors; the general shareholders’ meeting of a joint stock company may adopt a cumulative voting system in electing directors and supervisors in accordance with a company’s articles of association or shareholders’ meeting resolution.

# INVESTOR PROTECTION STRATEGIES PRACTISED IN KENYA

## Authority and Duties of Members [or Shareholders]

Members or shareholders [as owners] of the corporation jointly and severally protect, preserve and actively exercise the supreme authority of the corporation in general meetings. They have a duty, jointly and severally, to exercise that supreme authority of the corporation to:

* Ensure that only competent and reliable persons, who can add value, are elected or appointed to the Board of Directors;
* Ensure that the Board is constantly held accountable and responsible for the efficient and effective governance of the corporation so as to achieve corporate objectives, prosperity and sustainability.
* Change the composition of a Board that does not perform to expectation or in accordance with the mandate of the corporation.

## Appointments to the Board

Appointments to the Board of Directors should, through a managed and effective process, ensure that a balanced mix of proficient individuals is made and that each of those appointed is able to add value and bring independent judgment to bear on the decision-making process.

## Corporate Performance, Viability and Financial Sustainability

The Board monitor and evaluate the implementation of strategies, policies and management performance criteria and the plans of the corporation. In addition, the Board should constantly review the viability and financial sustainability of the enterprise and must do so at least once every year.

## *Accountability to Members*

The Board serve the legitimate interests of all members and account to them fully.

## Responsibility to Stakeholders

The Board identify the corporation’s internal and external stakeholders; agree on a policy or policies determining how the corporation should relate to, and with them, in creating wealth, jobs and the sustainability of a financially sound corporation while ensuring that the rights of stakeholders [whether established by law or custom] are respected, recognized and protected.

## Internal Control Procedures

The Board should regularly review systems, processes and procedures to ensure the effectiveness of its internal systems of control so that its decision-making capability and the accuracy of its reporting and financial results are maintained at the highest level at all times.

## Recognition and Protection of Members’ Rights and Obligations

Members of the corporation have a right to receive any information that would materially affect their membership, to participate in any meeting of members and to participate in the election of directors and be facilitated to fully participate in all other resolutions of interest to them as members.

## Audit Committees

The Board establish an Audit Committee composed of independent non-executive directors to keep under review the scope and results of audit, its effectiveness and the independence and objectivity of the auditors. The Audit Committee shall be given written terms of reference which deal adequately with their membership, authority and duties and shall meet at least twice a year.

# WORTH OF THE ABOVE STRATEGIES:

* That the Code of Best Practice for Corporate Governance, as previously circulated and subsequently refined through expert input and comments from corporate respondents, be adopted, printed and circulated as a guide for Corporate Governance in Kenya.
* Fair, efficient and transparent administration of corporations to meet well-defined objectives.
* Systems and structures of operating and controlling corporations with a view to achieving long-term strategic goals that satisfy the owners, suppliers, customers and financiers while complying with legal and regulatory requirements and meeting environmental and society needs;
* Transparent and open leadership with accurate and timely disclosure of information relating to all economic and other activities of the corporation.
* Build a consensus in favour of appropriate policy, regulatory and corporate reforms;
* Shareholders are furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meetings.

# Best strategy among above strategies:

The best strategy among above strategies is authority and duties of members. Because members or shareholders [as owners] of the corporation jointly and severally protect, preserve and actively exercise the supreme authority of the corporation in general meetings. They have a duty, jointly and severally, to exercise that supreme authority of the corporation. They ensure that only competent and reliable persons, who can add value, are elected or appointed to the Board of Directors.

# INVESTOR PROTECTION STRATEGIES PRACTISED IN INDIA

## Regulatory Response: Company Law

The primary protection to minority shareholders is laid down in the company’s law. Some of these provisions are the regulatory equivalent of an atom bomb - they are drastic remedies suitable only for the gravest cases of misgovernance.

## Protection of minority shareholders

Company law provides that a company can be wound up if the Court is of the opinion that it is just and equitable to do so. This is, of course, the ultimate resort for a shareholder to enforce his ownership rights. Rather than let the value of his shareholding be frittered away by the enrichment of the dominant shareholder, he approaches the court to wind up the company and give him his share of the assets of the company. In most realistic situations, this is hardly a meaningful remedy as the break-up value of a company when it is wound up is far less than its value as a “going concern”. It is well known that winding up and other bankruptcy procedures usually lead only to the enrichment of the lawyers and other intermediaries involved.

## Information disclosure

The company law itself mandates certain standards of information disclosure both in prospectuses and in annual accounts. SEBI has added substantially to these requirements in an attempt to make these documents more meaningful. Some of these disclosures are important in the context of dealing with the dominant shareholder. One of the most valuable is the information on the performance of other companies in the same group, particularly those companies which have accessed the capital markets in the recent past. This information enables investors to make a judgement about the past conduct of the dominant shareholder and factor that into any future dealings with him.

## Audit Committee

The main duties of an audit committee are to recommend the engagement or replacement of external auditors, to review the internal audit system, to oversee the interaction between the internal and external auditors, to inspect the company’s financial information and its disclosure, and to monitor the company’s internal control system. Companies are required by accounting law to set up a sound internal control system. The Code expects the audit committee to be chaired by an independent director and composed of a majority of independent directors. It also requires that at least one independent director on the audit committee should be an accounting professional.

## Stock Exchanges in India

India currently has two major stock exchanges--the National Stock Exchange, established in 1994, and the Bombay Stock Exchange (BSE), the oldest stock exchange in Asia, established in 1875. Until 1992 the BSE was a monopoly, marked with inefficiencies, high costs of intermediation, and manipulative practices, so external market users often found themselves disadvantaged. The economic reforms of the early nineties created four new institutions: the Securities and Exchanges Board of India (SEBI), the National Stock Exchange, the National Securities Clearing Corporation, and the National Securities Depository. The National Stock Exchange (NSE) is a limited liability company owned by public sector financial institutions and now accounts for about two-thirds of the stock trading in India, as well as virtually all of its derivatives trading.

## Take-overs

Instead of directly exploiting all the privileges that his controlling block gives him, the dominant shareholder can choose to sell his entire holding to somebody else. In a well functioning market for corporate control, he can expect to get a premium over the market price equal to the present value of all the privileges that the dominant shareholder can enjoy in future. The take-over regulations in India require that a slice of this cake be shared with other shareholders.

## Insider trading

Securities regulators around the world have framed various regulations to deal with the problem of insider trading. The existence of regulations does not necessarily mean that they are enforced. Most instances of insider trading have nothing to do with the dominant shareholder. Many of them involve small trades by junior employees who come to know of price sensitive information. In a few instances, insider trading may be indulged in by directors and other senior employees. In the context of this paper, however, the interesting cases are large scale trades by the dominant shareholder. Market gossip has long speculated on the prevalence of such trades in the build up to large mergers especially between group companies. Some promoters have merged small companies in which they have a large stake into a larger more widely held company at a swap ratio which is highly unfavourable to the widely held company. These allegations have been difficult to prove in most instances as the promoters can act through numerous friends, relatives and other fronts. When SEBI recently initiated action for insider against a large multinational in a somewhat different situation, the action proved to be highly controversial and the ultimate resolution of this case remains uncertain.

## Pricing of preferential share allotments

Another area in which SEBI has intervened to tackle the dominant shareholder is the pricing rule that it has imposed on preferential allotments. Company law itself provides that new issue of shares must be rights issues to existing shareholders unless the shareholders in general meeting allow the company to issue shares to the general public or to other parties. As has been pointed out earlier in this paper, the requirement of shareholder approval is quite meaningless when there is a dominant shareholder. Many dominant shareholders (both Indian and foreign) responded to the liberalization of the Indian economy by making preferential allotments to themselves at a small fraction of the market price. This regulatory intervention illustrates very nicely the problems that the regulator faces in dealing with governance abuses by the dominant shareholder. There are many situations where it may be in the interests of the company as a whole (and not just the dominant shareholders) to issue equity at below the six monthly average prices.

## Foreign Investment Implementation Authority (FIIA)

Government of India has set up Foreign Investment Implementation Authority (FIIA) to facilitate quick translation of Foreign Direct Investment (FDI) approvals into implementation by providing a pro-active one stop after care service to foreign investors, help them obtain necessary approvals and by sorting their operational problems. FIIA is assisted by Fast Track Committee (FTC), which have been established in 30 Ministries/Departments of Government of India for monitoring and resolution of difficulties for sector specific projects.

# WORTH OF THE ABOVE STRATEGIES:

* Economic reforms have not only increased growth prospects, but they have also made markets more competitive.
* Globalization of our financial markets has exposed issuers, investors and intermediaries to the higher standards of disclosure and corporate governance that prevail in more developed capital markets.
* Disclosure of information is the pre-requisite for the minority shareholders or for the capital market to act against errant managements. The regulator can enhance the scope, frequency, quality and reliability of the information that is disclosed.
* Regulatory measures that promote an efficient market for corporate control would create an effective threat to some classes of dominant shareholders.
* Regulatory intervention illustrates very nicely the problems that the regulator faces in dealing with governance abuses by the dominant shareholder. There are many situations where it may be in the interests of the company as a whole (and not just the dominant shareholders) to issue equity at below the six monthly average prices.
* Corporate governance abuses perpetrated by a dominant shareholder pose a difficult regulatory dilemma in that regulatory intervention would often imply a micro-management of routine business decisions.
* Corporate governance, which is the system that helps firms control and direct operations, is in the spotlight as key parts of the governance framework such as audit and finance functions have failed to check the promoter-driven agendas.
* Company’s financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.

# Best strategy among above strategies:

The best strategy followed by India is regulatory response. Laws and regulations followed by India is major concern for investors. The primary protection to minority shareholders is laid down in the company’s law. Some of these provisions are the regulatory equivalent of an atom bomb - they are drastic remedies suitable only for the gravest cases of misgovernance.

# INVESTOR PROTECTION STRATEGIES PRACTISED IN PAKISTAN

## Treatment of Shareholders

The World Bank notes that the Securities and Exchange Ordinance of 1969 (SEO 1969) regulates insider trading, and the laws are enforced by the SECP, which has also issued Insider Trading Guidelines. Any "associated" person is prohibited from trading in his or her company's shares if he has information not "generally available", and which would affect the price of the securities, or related to any company transaction. "Associated" people include officers, employees, and any person with a "professional or business relationship which gives them access”.

Following the assessment a number of recommendations were made and the World Bank noted that although shareholders are required to disclose direct and indirect ownership, market participants cautioned that generally only direct ownership is reported. Also, many shareholders avoid this requirement by holding less than the 10 percent threshold. The World Bank recommended that the requirement for shareholders to disclose indirect ownership should be clarified in the law. Further, companies should be required to disclose a list of significant shareholders in their annual report and shareholders should disclose all shareholder agreements.

## Role of Stakeholders

The World Bank assessment explains that creditor protection used to be in Pakistan. The establishment of Banking Courts and legal changes to facilitate the collection and resale of collateral has improved the protection of creditors' rights. In addition, the report adds, "a variety of standard measures developed by the World Bank for 130 countries confirm that compared to its regional neighbours, Pakistan has relatively strong creditor rights”. The report adds that while employees do not have a right to sit on boards, they are represented by works councils. Creditors can nominate directors to the board "by virtue of contractual agreement" and some companies have also started to adopt whistleblower policies. The World Bank explains that "labour/trade unions have a 'collective bargaining agent' who presents the grievances of employees on their behalf. However there is no specific whistleblower protection under the law".

## Disclosure and Transparency

Companies Ordinance provides a regime for detailed financial disclosure requirements and, more specifically, Section 233 of the Ordinance mandates the presentation by directors of a balance sheet and a profit and loss account at every annual general meeting. These reports are to be accompanied by an auditor's report and a director's report required to be made available to every member of the company, the SECP, the stock exchange and the Registrar. Nevertheless, the World Bank notes that although Pakistan has a Code of Corporate Governance in place since 2002, there are no disclosure requirements regarding employees and other stakeholders in the law or Code. With regards to financial reporting, according to the 2005 Accounting and Auditing Report on the Observance of Standards and Codes (ROSC) by the World Bank, Pakistan has "largely" adopted International Financial Reporting Standards (IFRS) as promulgated by the SECP in consultation with the Institute of Chartered Accountants of Pakistan (ICAP). Pakistan has also adopted International Standards on Auditing (ISA) without any modifications, however it is unclear whether all the latest revisions made by the International Auditing and Assurance Board have been incorporated. Further, members of ICAP must follow the Code of Ethics, revised in 2003 to comply with the IFAC Code.

## The Responsibilities of the Board

Code of Corporate Governance was to "restructure the board of directors in order to make it accountable to all shareholders; to strengthen internal control systems of corporations; to foster better disclosure and to strengthen internal and external audit requirements of listed companies". The report also points out that "the Code makes a bold attempt at giving some definite shape and direction to the role of the Chairman of the BODs [Board of Directors] in Pakistan's Corporate Governance environment". However, according to the World Bank, fiduciary duties are relatively under-developed in Pakistani law. The assessment notes that "existing fiduciary duties are based primarily on a limited amount of case law, which is sparse and emphasizes loyalty to the company (not shareholders) and the provisions on conflict of interest in the Companies Ordinance (CO)". Pakistan has been taking a few initiatives in that direction and in 2004 the Pakistan Institute of Corporate Governance (PICG) was established to provide an enabling environment for effective implementation of the Code of Corporate Governance. The World Bank observed that the PICG can play a major role in the development of implementation guidelines for boards, and for audit committees. The assessment found the Code's provisions for independent directors relatively weak and recommended that independence provisions of the Code be clarified. In addition, it recommended that the Code should contain an explicit recommendation/requirement that companies should pay adequate compensation to all board members.

## Ensuring the Basis for an Effective Corporate Governance Framework

The IMF's Financial System Stability Assessment conducted in 2004 concluded that Pakistan's corporate governance regulations are extensive and comprehensive. In addition to the detailed corporate governance provisions in the Company Ordinance the report points out that the SECP "issued a detailed Code of Corporate Governance in March 2002 for all listed companies that is broadly in line with OECD Principles".

The SECP ensures compliance with the law, the Code and the listing requirements for listed entities. Listed companies only require a statement of compliance signed by a verified accountant and compliance may not always be achieved. The World Bank recommended that the SECP should work towards building its enforcement capability. The report added that "key steps include increasing the technical level of staff in key areas (particularly legal and accounting experts), continuing to define enforcement priorities, and refining enforcement procedures". The State Bank of Pakistan (SBP) is the central bank and is responsible for regulating the banking and financial sector. In addition to the Code, banks must comply with the Prudential Regulations of the SBP and the Banking Ordinance of 1962.

# WORTH OF THE ABOVE STRATEGIES:

* Code of Corporate Governance has established a framework for good corporate governance practices for listed companies.
* International Monetary Fund Financial System Stability Assessment report reiterated that Pakistan's corporate governance regulations are "extensive and comprehensive" and the Code of Corporate Governance is broadly in line with Organization for Economic Co-operation and Development (OECD) Principles.
* Disclosure of ownership, reporting of related party transactions, and rules on Annual General Meetings has made the investors beneficial.
* World Bank rates investor protection in Pakistan as being above the regional and the OECD averages.
* The functioning of control arrangements" was rated as "Partially Observed," indicating that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge.
* The World Bank noted that overall; the legal framework for basic shareholder rights is well established in Pakistan.
* Companies disclose a list of significant shareholders in their annual report and disclose all shareholder agreements.

# Best strategy among above strategies:

The best strategy followed by Pakistan is transparency and disclosure. If disclosure are made in time with transparency in all regards makes the investors trust and invest in future. Ordinance mandates the presentation by directors of a balance sheet and a profit and loss account at every annual general meeting. These reports are to be accompanied by an auditor's report and a director's report required to be made available to every member of the company, the SECP, the stock exchange and the Registrar. Pakistan has also adopted International Standards on Auditing (ISA) without any modifications.

# INVESTOR PROTECTION STRATEGIES PRACTISED IN NEWZELAND

## Audit & Risk Committee

The function of the Audit and Risk Committee is to oversee financial reporting, accounting policies, financial management, internal control systems, risk management system, systems for protecting assets and compliance.  The Committee keeps under review the scope and results of audit work, its cost effectiveness and performance, independence and objectivity of the auditors.  It also reviews the financial statements and the announcement to the New Zealand Exchange concerning financial results.

## Role of the Board

The Board of Directors is elected by the shareholders to supervise the management of the Company. The Board establishes the Company's objectives, overall policy framework within which the business of the Company is conducted and confirms strategies for achieving these objectives, monitors management's performance and ensures that procedures are in place to provide effective internal financial control. The day to day management responsibilities of the Company have been delegated to Morrison & Co Infrastructure Management Limited ("MCIM").

## Internal Financial Control

The Board has overall responsibility for the Company's system of internal financial control. The Directors have established procedures and policies that are designed to provide effective internal financial control. Annual budgets and long term strategic direction are agreed by the Board. Financial statements are prepared monthly and reviewed by the Board throughout the year to monitor performance against budget targets and objectives.

## The Role of Shareholders

The Board aims to ensure that shareholders are informed of all major developments affecting the Group's state of affairs. Information is communicated to shareholders in the annual report, interim report, two updates, regular e-mail updates and media announcements. The Board encourages full participation of shareholders at the annual meeting to ensure a high level of accountability and identification with the Group's strategies and goals.

## Legal environment

The concentration of ownership and poor development of financial markets are consequences of Newzeland’s weak legal environment. Recent research has shown that it is strong law enforcement, rather than the mere content of the laws, that is crucial for the ability of firms to attract external finance. While Newzeland quickly caught up with the West in adjusting their company and bankruptcy laws to Western standards, law enforcement remains poor. This is primarily due to widespread corruption in courts, regulatory bodies and law enforcement agencies.

# WORTH OF THE ABOVE STRATEGIES:

* Control of management and on analysis of company financial statements, on the contrary, decreased with the management’s share.
* The Federal Financial Markets Service (formerly the Federal Commission for Securities Markets) introduced the Code of Corporate Conduct. Private agencies are proposing their own initiatives and publishing their own corporate governance ratings.
* The legislators have begun to introduce amendments in the laws aimed at stopping the practices of “black” and “grey” takeover schemes, while investigation and enforcement agencies have started to scrutinize “strange” court rulings, punish some judges for unjust decisions, and file criminal charges against some raiders.
* Governments of different levels can in fact be considered as companies’ stakeholders, whose goals may significantly diverge from the firm value maximization.
* Recent and proposed legal reforms can alleviate the problem of insecure property rights. However, fighting corruption and changing public and government attitudes towards privatization deals are crucial steps in the development of a sound corporate governance system.

# Best strategy among above strategies:

The best strategy for investor’s protection is internal control system. Internal control system doesn’t allow any kind of fraud and helps to increase the company’s values. The Directors have established procedures and policies that are designed to provide effective internal financial control. Annual budgets and long term strategic direction are agreed by the Board. Financial statements are prepared monthly and reviewed by the Board throughout the year to monitor performance against budget targets and objectives

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