

Organisational Studies and Innovation Review

Vol. 2, no.4, 2016

Frauds in Corporate India: Comparison among Four Major Corporate Scams

Chahna Jhaveri*

*Pandit Deendayal Petroleum University**

Abstract: Fraud is a problem that cannot be easily controlled or managed within organisations today. The dictionary meaning to it is – a wrongful or criminal deception intended to result on financial or personal gain. According to a survey, about one third of organizations worldwide were a victim of economic crime (fraud) within a period of two years. Though fraud is a serious risk that presents to business, many organisations still lack formal systems and procedures in place to prevent, detect and respond to fraud. 31% of the Indian respondents experienced economic crime in the last two years, according to a recent research by PWC. Fraud may even be increasing due to greater globalisation, more competitive markets, rapid developments in technology and periods of economic difficulty. This research paper presents the cases of four scams that happened in India. The paper compares four large scams as to the size of the scams, mode of operations, stakeholders affected, and involvement of government employees. The details on actions taken by government are also included. It also looks into the specific cases to reveal the nature of corporate scams in India, their ethical implications and how can they be prevented.

Key words: *corporate scams, frauds, India, government*

Introduction

Profit is the primary motive for any corporate firm, irrespective of the size of the firm. But the greed of earning exorbitant profits may lead the firm or the owners to commit crimes such as frauds. Frauds take place when a firm and the owner practice such activities which are not permissible by the host government. Globally, organizations lose 5% revenue which is around \$3.7 trillion each year due to fraud, according to the Association of Certified Fraud examiners (ACFE). Frauds have been a major issue for India since 1940s jeep scandal case till the most recent scam by Vijay Mallya who is the owner of UB group. According to a study by ASSOCHAM-Grant Thornton, over last three years reports filled for frauds have been increased by 45% in India.

Some of the notable corporate frauds caused around the world are: The Volkswagen emission scandal, FIFA corruption scandal, Toshiba accounting scandal, Valeant's secret division, World com, Arthur Andersen LLP and the list continues. So the purpose that this paper shares is to discuss about the corporate frauds that took place in India, how

these frauds have affected the Indian economy, how are the investors and stake holders are affected and the involvement of the host government. It also discusses about the ethics by which the owner should run the business.

Ethics guides the society to sense what is right or wrong, good or bad and their purpose and aftermath. When these ethics are used in business it is said to be business ethics. Ethics are accepted rules by the society. Every manager in the society is expected to follow religion, culture and the legal system of the country which are considered as the source of business ethics. To follow ethics for any business is important as they ensure credibility with the public, ensure management credibility with employees, helps to take efficient decisions and it co-relates with basic human needs.

Any business, Is dependent on the society for its inputs like money, skills and labour. It is only the society that gives business a market to trade its products. So being so much dependent on the society, business has some responsibilities towards the society too known as, corporate social responsibility (CSR).

Ethisphere Institute released a list of 131 companies which according to the institute were most ethical companies around the world. The list include three companies from India namely, Tata power Ltd., Tata steel Ltd. and Wipro (Forbes). As we discussed about ethical and trusted companies of India, we would now get into the details of 4 of the biggest corporate scams.

4 major corporate scandals of India

1. Sahara scam

Mr Subrata Roy, Indian business man, founder and chairman of Sahara India, named amongst top 10 most powerful people of India was arrested on 28th February, 2014 for failing to refund its investors an amount of \$3 billion deposits. Sahara group was one of the India's largest employer's and had overseas assets like new York's plaza which made the group India's major financial institution. All these assets were built through the tiny investments made farmers, vendors etc. whose monthly income was hardly \$35 to \$50. In 2008-09, two companies belonging to Sahara group, Sahara housing investment corporation (SHIC) and Sahara India Real Estate Corporation issued optionally fully convertible debentures (OFCD) to public which helped them to raise thousands of cr. of funds. Optionally fully convertible debentures (OFCD) are a type of bond which can be converted to debenture by the investor whenever they want. Around 23 million people from villages and small towns invested in this scheme and a total of \$3.5 billion was received by these companies.

Securities and exchange board of India (SEBI), whose main function is to protect the money of the investors of the country came to know about this scheme when it was reviewing the red herring prospectus (RHP), submitted by Sahara prime city limited another company of Sahara group. It was a mere accident. They came to know that both the companies were raising funds without complying with the rules and regulations given by RBI. SEBI wasn't aware about them offering the public issue. They hadn't filled any draft red herring prospectus (DRHP) to SEBI through which it can come to know. This was a standard process that any company in India has to follow. By November 2010, SEBI held back both the companies from raising more funds through OFCD. Sahara group was dragged to the court by SEBI in December 2010. Arguments were made by Sahara that OFCD scheme comes under union ministry affairs rather than SEBI. Various arguments were made that like this was in a form of private placement; SEBI cannot take

action against unlisted companies etc. But all bogus arguments failed in front of the Securities Appellate Tribunal (SAT) and the supreme court in 2012.

The verdict passed by the court was to refund all the money to 2.21 cr. investors with 15% interest. As he failed to appear at the court during the case he was taken to the custody in Tihar jail Delhi. He got his interim bail in august, 2014 at the cost of \$10 million to perform last rites of his passed mother. This bail was extended till 24th October, 2014.

Sahara has yet not been able to return the money of the investors as they did not bothered to even maintain a proper record of the investors and the amount payable was \$5840000000 with 15% interest. He could even raise the capital was because he had contacts with some of the top politicians and corporate leaders. Latest update is that the group is ready to pay amount of \$30 million. Mr Subrata roy is out today on bail.

Loopholes due to which Sahara was able to do this in the first place:

- Commercial dealings lacked transparency back then due to which Sahara group could do this in such a short period of time.
- Lag in court procedure regarding disposing cases, which normally take years and it supports scams. Indian judicial system is overburdened by cases of corporate nature and it promotes crimes in financial sector.
- Insufficient powers and jurisdictions among different agencies that implicated regulation of the conduct of the business. For example, here SEBI had difficulty in dealing with unlisted (in stock exchange) companies. SEBI has normally the powers to regulate the business of only listed companies in India and that was the vindication of Sahara at Supreme Court against SEBI.

Change in the rules and regulations by government and SEBI after this major scam.

- As you've seen in this case, Sahara's key argument was SEBI doesn't have jurisdiction over their OFCD investment scheme, because that money was meant for their "unlisted" companies.
- According to Companies Bill 2012, SEBI will have undisputed jurisdiction over any investment scheme involving more than 50 investors-It doesn't matter whether you're a listed company or an unlisted companies.
- By SEBI
- In 2013, Government introduced Securities Laws (amendment) Bill, 2013. This helped SEBI to take better actions against Sahara and other such companies.
- Though it couldn't be passed, but since the matter was of great importance, government decided to implement the provisions as an ordinance.

2. Saradha chit fund

India, having large rural population was dependent either on money lenders who would charge brutally high interest rates or on Indian postal services for small saving schemes, result of lack of banking facilities. In 1980-1990 people got attracted to low interest rates which encouraged a rise of Ponzi schemes. Such schemes were ran by huge companies which collected money from people in the name of collective investment schemes, chit funds, non-convertible debentures etc. in 2013, 80% complaints received regarding such schemes were from the companies in West Bengal. It was a time when West Bengal was said to be the "Ponzi capital of India"

One such Ponzi scheme was introduced by a group called Saradha, a combine of 200 companies. It was not only one of the biggest financial scam of India but also a political scandal. The company was operating a collective investment scheme which they used to wrongly refer as chit funds. The company was shredded into pieces in April 2013. It collected a total amount of 200-300 billion rupees from 1.7 million investors or depositors. They managed to collect such a huge amount was merely by building trust of its targeted public. They invested lot on its brand building by recruiting actresses, Trinamool congress (TMC) and Member of Parliament as its brand ambassadors. Mithun Chakraborty a Bollywood actor, TMC and MP was a brand ambassador of Saradha group. Kunal Ghosh a TMC and MP was recruited as CEO of Saradha media group. Hence this also became a political scandal as the chief minister herself, Mamta Banerjee was involved in the scheme as she was she one who persuaded to use Saradha's services like ambulances and motorcycles in a particular area of Midnapore. The group also used to sponsor various durga pujas organised by political leaders. In fact even the name of the group is also named after the wife of Ramakrishnan Paramhans a 19th century mystic of Bengal.

The group did what all other used to do, demanded money and promised high returns. Agents or managers were given jobs to sell funds and they would get their commission. These agents were from rural areas as the group could easily get illiterate people there. These agents received 30 to 45% deposits as commissions which were higher than any other pays. A link of companies were made by the group to launder money and evade it. Originally the company collected money from public by issuing debentures and redeemable bonds. Then SEBI came to know that the company was raising capital from more than 50 people and it was not informed, they confronted the Saradha group in 2009 as it was breaking the law keeping it from SEBI. The group changed its methods of raising money. They informed most of the people wrongly that it was a chit fund. People kept on investing due to its brand name. The state government of West Bengal was forewarned by SEBI about the Saradha group and its chit fund activities in 2011. Simultaneously the group started laundering and hiding money by transferring them to Dubai, Singapore and South Africa. By 2012, SEBI was successful in getting orders against the operation of all the investment schemes ran by the group and orders them to stop raising money through such schemes, by classifying between chit funds and collective investment schemes (CIS). Saradha did not give a hid to the orders and continued to do so as a result the group collapsed by April, 2013.

On 6 April 2013, a confession letter was written by Sen where he accepted that he corrupted several politicians. He stated the name of TMC leader Kunal Ghosh. After writing the letter sudipto sen flew away and he was arrested after a week from Kashmir, sonmarg. Along with him, Debjani Mukherjee was also arrested who was one of the executive directors. The group was ordered to deposit the all the funds within three months.

The group was liable to pay \$369.6 million out of which 80% of the depositors are not still unpaid. On 30 April 2013 CBI started investigating into the Saradha Group scandal. In February 2014, Sudipta Sen was convicted in a case where he was charged, under various provisions of employment law, as the firm owed 3 million to his employees. He was sentenced by the trial court to three years in jail; it was the first conviction in a series of civil and criminal cases, relating to corporate fraud and non-payment of deposits,

pending against him. By April 2014, 385 FIRs against Sardha Group, in which SIT filed 288 charge sheets, had been filed.

3. Satyam fraud

Satyam computer was established by Raju ramalinga with his brother and brother-in-law in 1987. By 2008, Satyam revenue crossed \$2billion. By January 2009, Satyam was barred from doing business with the World Bank for eight years as it claimed that Satyam was involved in data thefts and bribery. The shares fell the lowest in four years. This was the time when the founder-chairman, Raju ramalinga confessed his fraud by delivering a letter to his employees and resigned from his chairmanship. In the letter he disclosed that he committed an accounting fraud of rupees \$1180.7 million in the balance sheets of Satyam computer. By January 8, 30 bank accounts of Satyam were freeze by Citibank. The very next day Raju Ramalinga and his brother were arrested. Satyam was removed from nifty and Sensex. By Feb. CBI started an investigation, and was able file three charge sheets but they failed to do it on time and Raju was released on bail in November 2012. By april, 2013 verdict was passed and 10 people were found guilty, B. Ramalinga Raju; his brother and Satyam's former managing director B. Rama Raju; former chief financial officer Vadlamani Srinivas; former PwC auditors Subramani Gopalakrishnan and T Srinivas; Raju's another brother Suryanarayana Raju; former employees G. Ramakrishna, D. Venkatpathi Raju and Ch Srisailam; and Satyam's former internal chief auditor V.S. Prabhakar Gupta.

Raju and his brothers have to pay a fine of \$800000 and a sentence of 7years in jail.

4. Kingfisher loan default case

Vijay Mallya, business man and a politician, who is known for his exorbitant life style, was given his father's business, United Breweries group to handle at the age of 28. Vijay Mallya was able to make a \$6 million business to \$901 million. Then enters the kingfisher airlines, a company of the same group where Vijay Mallya was the founder, was set up in 2003 but was not able to gain profit since 2006, the year when it got listed. The services provided by the airline attracted the customers in the initial years. Mr Mallya wanted his monopoly in the market. So first he fetched his eyes on air Deccan and bought 26 of the stake in the company by paying \$82.6 million. Though company was facing losses every year it did not stopped to introduce its new airlines. When fuel price hiked in the market it became a difficult task for the airline to provide air-line services and run a low cost carrier. The debts started increasing; by the end of March 2008 reported debt was \$140 million. And by 2009-10 debt increased to \$1052 million due to constant rise in fuel prices. The airline failed to pay its landing charges. No petroleum company was ready to provide fuel until the airline paid in cash. The company was not even able to pay to its employees, weather its ground staff or pilots. A CBI inquiry was issued where it came forward that many banks gave loans to the airline despite its continuous losses. The loan of \$1046 million was accepted only because of political strings attached with Vijay Mallya. There were few more private banks which gave loans but they bought equity shares during that time when the price was \$1 per share which never came up to \$0.66 after this inquiry was set up. The airline took the loans against the properties it had. But then the banks came to know it had no moveable property which could be sold off and the money could be recovered. United bank declared Vijay Mallya as a wilful defaulter in September 2014. In 2015, CBI started questioning Vijay Mallya on the default of such a huge amount. And this amount has now increased to \$1352.8 as

interest was also not paid. Mallya was asked not to leave India till the inquiry ends but due to the political strings he was able to move leave India in March 2016. Mallya offers to pay \$601 million and no interests, only the principle amount as Supreme Court hears the case. But as banks refuses to the deal he was asked to disclose all the assets. His diplomatic passport was cancelled and a non-billable warrant is issued.

According to the recent interview, he said he had no plans to return India. If he doesn't come back, he will be left unpunished. Though India has asked many of the country to hand over Vijay Mallya to India if he enters there boundaries.

Conclusions

Sahara scam and Saradha chit fund scam, both was about investments, but the method was way too different. Both scams tried to raise money from public as investments but Sahara through fully convertible debentures and Saradha through chit funds. In Saradha chit fund it was not only an economic fraud but also a political scam where the names of political leaders were involved. The size of Sahara scam was huge then compared to any other scam. The satyam scam was an accounting fraud and kingfisher was a bank fraud. With every scam and fraud the economy gets hit hard and its affect also stays for long time. When such huge scams take place it is natural that somewhere or other corruption takes place. Money is offered and accepted somewhere, especially in a giant economy like India and due to which economy faces many indirect losses. The victims due to scam is first one to get affect directly and most of the time the amount they lose is not recovered even though the culprit is arrested.

References:

N.p., 2016. Web. 15 Nov. 2016.

Sahara:

N.p., 2016. Web. 15 Nov. 2016.

"Sahara Money Laundering Case: Almost 95 Per Cent Money Flow Was In Cash, ED Goes For Data Analysis After Searches". *Indiatoday.intoday.in*. N.p., 2016. Web. 15 Nov. 2016.

"Subrata Roy'S Sahara Group Case: All You Needed To Know In 5 Points". *The Financial Express*. N.p., 2016. Web. 15 Nov. 2016.

"[Economy] SEBI-Sahara OFCD Case: Optionally Fully-Convertible Debentures-Meaning Explained - Mrunal". *Mrunal*. N.p., 2016. Web. 15 Nov. 2016.

Saradha:

N.p., 2016. Web. 17 Nov. 2016.

"Saradha Group Financial Scandal". *En.wikipedia.org*. N.p., 2016. Web. 17 Nov. 2016.

"Sahara Money Laundering Case: Almost 95 Per Cent Money Flow Was In Cash, ED Goes For Data Analysis After Searches". *Indiatoday.intoday.in*. N.p., 2016. Web. 15 Nov. 2016

Satyam:

Balachandran, Manu. "The Satyam Scandal: How India'S Biggest Corporate Fraud Unfolded". *Quartz*. N.p., 2016. Web. 17 Nov. 2016.

"Satyam Scam: All You Need To Know About India's Biggest Accounting Fraud". <http://www.hindustantimes.com/>. N.p., 2016. Web. 2 Dec. 2016.

Kingfisher:

"From Bang To Bust: The Kingfisher Story". *The Indian Express*. N.p., 2016. Web. 17 Nov. 2016.