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Efficacy of Corporate Governance in Curbing Corporate Frauds in India

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ABSTRACT

In recent times, corporate frauds have been snowballing in the corporate world mainly due to poor corporate governance. The reporting and publication of such frauds are taking an enormous amount of time to be thrust into the limelight. It is mainly due to the fact that those committing such frauds are well-equipped with the knowledge of exploiting the legal loopholes to their advantage and using advanced technologies to commit such corporate scams and evade dire consequences. Eventually, the interests of the stakeholders, particularly the minority shareholders are at stake. Hence, it is advisable to enhance robust corporate governance by incorporating a proper code of conduct for the directors and executives and other employees of a corporation and there should be an independent ethical officer who can oversee the activities of the dominant shareholders and higher authorities and make them accountable for all their actions that are detrimental to the interests of the company and its stakeholders. Corporate frauds could be mitigated if there is a proper compliance mechanism by regulatory bodies and proper implementation of the standards of corporate governance.

***Keywords**: Corporate frauds, Corporate governance, Minority shareholders, Dominant shareholders, Independent ethical officer.*

I. INTRODUCTION

Having traced the global corporate history, it is more obvious and an incontestable fact that corporate frauds have become an integral part of corporate history and therefore, sound corporate governance is the effective remedy to it. Proving this statement, a series of corporate frauds say, *the Enron debacle (2001)* in the United States of America, *the Satyam debacle (2009)* in India, etc. made the governments and all the corporations concentrate more on improving the standards of corporate governance that would ultimately result in the development of the corporation and the nation as well. Nevertheless, it is also notable that even the critically acclaimed corporate governance principles cannot thwart the instances of

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corporate scams. However, certain preventive measures taken by the regulators and the corporations before the occurrence and the immediate punitive action at the time of the occurrence of corporate frauds are always commendable.

Following several corporate frauds and their impact on the economic efficiency of the company and the nation, many countries aimed at enhancing sound corporate governance. Accordingly, the US enacted the 'Sarbanes Oxley Act, 2002' (widely recognized as "SOX") highlighting the mandatory requirements for public companies to ensure good corporate governance. The UK was the pioneer to introduce the code of corporate governance through its Cadbury Report, 1992. Most recently on 22.01.2024, the Financial Reporting Council (FRC) issued the 2024 UK Corporate Governance Code (UKCGC)[3] aimed at enhancing corporate transparency and accountability. The Organisation for Economic Cooperation and Development (OECD)[4] has framed the fundamental global standard of corporate governance principles and expected it to be adopted by all the member countries. These principles act as the international benchmark of standard corporate governance and act as a reference tool even for non-OECD countries. Though they have been acknowledged by the member countries, they have not been implemented effectively since such principles have no legal binding in force.

In India, in April 1998, the Confederation of Indian Industry (CII) released a Task Force Report entitled *'Desirable Corporate Governance: A Code'* which outlined a set of voluntary recommendations for the best corporate governance practices, particularly focused on the listed corporate entities. Thus, the CII has pioneered the corporate governance movement in India. The Securities and Exchange Board of India (SEBI) had then taken another major initiative and inserted a new Clause 49 in its Listing Agreement in 2000. Various Committees were specially appointed to provide recommendations on the regulatory measures and standards of corporate governance to SEBI and the Ministry of Corporate Affairs (MCA) and thereby, they assisted in issuing several guidelines for good corporate governance on a timely basis.

The Companies Act, 2013 (hereinafter referred to as "the 2013 Act")[5] finally passed with certain key provisions ensuring better corporate governance say, the appointment of women directors, independent directors, related party transactions (RPTs), corporate social responsibility (CSR)

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[3] The 2024 UKCGC replaced the 2018 UK Corporate Governance Code. However, it will apply to financial years beginning on or after 1st January 2025 until then the 2018 Code will remain in force.

[4] The Organisation for Economic Co-operation and Development is an international organization founded on 14th December 1960 to stimulate economic progress and world trade and it works to build better policies for better lives.

[5] The Companies Act, 2013 was passed by the legislature by repealing the years old 'The Companies Act, 1956' after 'The Companies Bill, 2013' having obtained assent on 18th December 2012 and 8th August 2013 from the Lok Sabha and the Rajya Sabha respectively and on 29th August 2013 from the President of India with 470 Sections, 29 Chapters and 7 Schedules.

and so on. The 2013 Act also emphasised mandatory adherence to the Secretarial Standard issued by the Council of the Institute of Company Secretaries of India (ICSI)[6].

Good corporate governance is needed to safeguard the interests of the corporation and its stakeholders. The task of promoting and maintaining corporate governance predominantly vests with the directors of a corporation. In order to curb corporate frauds, the directors, executives and other employees of the corporation must strictly adhere to the code of corporate governance. The Board of Directors (BoD), executives and other employees at all levels of the organization must act in accordance with the four major pillars of corporate governance say, transparency, accountability, responsibility and fairness. Good corporate governance plays a significant role in the prevention, detection and addressing of corporate frauds. Mitigation of corporate frauds via robust corporate governance would attract more investments from abroad which stands as conclusive evidence of the flourishment of the corporation in the Indian Capital Market and the economy of the nation as a whole.

(A) Objectives of the study:

i. To know the significant elements of good corporate governance.

ii. To analyse the various corporate frauds in India.

iii. To suggest some remedial measures to curb the corporate frauds.

(B) Review of literature:

Gupta & Gupta (2015) found that the regulatory system is weak, and there is an urgent need to redefine the role of auditors. Further suggested that corporate frauds could be mitigated by proactive and conscious action by auditors; mandatory publication of fraud prevention policy; constitution of special purpose corporate office wing; recognition to companies for improved corporate governance; true adoption of International Financing Reporting Standards; due diligence by banks and financial institutions; compulsory appointment of professionals by shareholders and fixation of responsibility on independent professionals; intellectualisation of audit committee; and more powers to the regulators, especially SEBI. Furthermore, he has rightly observed that the prevention of corporate frauds reduces anxiety, improves corporate image and builds up the confidence of the investors, which is essential for resource channelling in financial markets.

Moses (2019) concluded that increasing the number of independent directors will enhance the board's ability to prevent the occurrence of fraud, however, the ability of directors to maintain

[6] Refer *Section 118 of the Companies Act, 2013.*

independence and prevent corporate fraud is below the ideal level. In addition, it was concluded that the dedication of the audit committee is a pivotal deterrent of corporate fraud. To curb corporate fraud, it was further suggested that concentration of ownership in a few hands can be reduced through legislation.

(C) Scope and limitations of the study:

This study mainly relies on secondary sources of data and it predominantly analyses a few corporate frauds that occurred only in India.

II. SIGNIFICANT ELEMENTS OF SOUND CORPORATE GOVERNANCE

Soon after *the Enron debacle (2001)*[7], many corporate frauds in the USA gained the attention of the stakeholders and the lacunae of sound corporate governance was felt globally. In no time, the US regulators had sprung up with a new Act, the Sarbanes-Oxley Act ("SOX") in 2002. The scams from giant corporations across the global countries made the concerned regulators come up with new enactments that accentuate the improvement and maintenance of good corporate governance and penalize the defaulters with rigorous punishment.

In India, due to the adverse effects of *the Satyam Scam*, CII took an initiative to improve corporate governance by releasing a *'Desirable Corporate Governance: A Code'*. Then the MCA and SEBI put in enormous efforts to enhance the corporate governance and to safeguard the interests of the investors. Clause 49 of the SEBI's Listing Agreement is considered quintessential in making the corporates adhere to the standards of corporate governance. The 2013 Act was enacted with various provisions emphasizing the standards of corporate governance.

ICSI, a premier institute in India working ardently towards improving the standards of Corporate Governance, has drafted the International Corporate Governance Code (ICGC) for mounting the entire corporate world to its next level of adherence to corporate governance in letter as well as in spirit.

ICSI suggests the following aspects to enhance good corporate governance:

a. A comprehensive approach to social responsibility and the Indexation of Humanity;

b. Pertinency of governance of corporation to all classes of corporate enterprises;

c. A propensity towards self-regulation contrary to legal requirements;

[7] Hailed by Fortune magazine as "America's Most Innovative Company" for six straight years from 1996 to 2001, Enron became one of the largest bankruptcies in US history.

d. Incorporating the business perspective into corporate administration and management as opposed to a perception;

e. The necessity of globally accepted standard practices.

Some of the significant components of sound corporate governance are as follows:

1. The BoD is the major stakeholder of a company that influences all the corporate decisions. It is the nucleus of the corporate governance system and is empowered to boost the value of the business and the stakeholders by controlling and managing the overall corporate affairs. The powers, roles and responsibilities of the directors must be well defined in a Board Charter and their letters of appointment. The roles of the BoD can be summed up as follows:

- defining the vision and mission of the corporate entity;
- outlining the values that the firm has to adhere to regularly;
- identifying the appropriate stakeholders involved in the operations of the corporate firm;
- coming up with a strategic plan in combination with all the above-mentioned aspects; and
- to guarantee the proper execution of the above-said strategy.[8]

2. The shareholders elect a BoD by passing a resolution at a general meeting and the directors so appointed must be well-equipped with greater skills, knowledge, intellectual vision, effective training and rich experience and follow the best ethical business practices to discharge their functions effectively and efficiently to enhance the economic efficiency of the company.

3. An unequivocal law and well-constructed rules and regulations are essential to proper management of the corporation. The provisions contained in the 2013 Act with the associated rules and other laws must be strictly adhered.

4. For good corporate governance, the independence of the BoD from the executive team and any profitable businesses with the company is *sine qua non*. The executive team directly reports to and is supervised by the BoD.

5. Board meetings, where the major decisions for the well-being of the firm and its stakeholders are proposed, must be attended by the directors regularly by preparing well in advance.

[8] The King Report (a South African report on corporate governance).

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6. The corporate goals should be well drafted in a long-term corporate strategy including a yearly business strategy along with practically feasible and assessable performance goals and milestones.
7. Commercial objectives of the company and community service obligations must be properly drafted after having obtained consent from the BoD. The timely information to all the stakeholders regarding the current and projected strides taken to fulfil the obligations of the community is necessary.
8. The comprehensive financial and operational reports including status reports and other relevant information must be provided to the BoD at regular intervals or whenever the BoD calls for such reports and information to facilitate it carrying out its function of supervising the performance of the corporate enterprise and to make crucial decisions.
9. The BoD should oversee and assess its performance as well as the performance of every individual director regularly using key performance indicators (KPI) in addition to peer review. It must set up a proper system for reporting the performance evaluation results of the directors.
10. The Audit Committee considerably contributes to the administration and management of the firm by reviewing and fully disclosing the corporate financial statements by adhering to the relevant policies and standards and by reporting any concerns to the BoD. There must be proper and regular internal audits to ensure the integrity of financial and operation reporting and to identify the issues that should be dealt with utmost good faith and diligence. Independent external audits act as a stimulator for the BoD and the executives to act diligently and to comply with the provisions of the 2013 Act or any other law for the time being in force, the Articles of Association (AoA) and the Memorandum of Association (MoA).
11. Proper strategic planning and effective risk management mechanisms assist in achieving the organisational goals.
12. Transparency, accountability and integrity of the BoD and the executives to all the stakeholders ensures a sound management and administration of a corporate enterprise.
13. There must be a proper *"checks and balances"* mechanism that protects the dominant shareholders from encroaching on the rights of the minority shareholders.
14. The best ethical business standards and a proper code of conduct must be followed by the BoD, management team and the employees of the corporation.

15. Every shareholder must be given an opportunity to voice out his opinion at a general meeting through his voting rights.

III. LANDMARK CASES WITNESSING THE CORPORATE FAILURES

Corporate frauds could be termed as the organisational or corporate crimes. They form a part of the white-collar crimes[9]. Various financial frauds that occurred in India including *East India Company Fraud, Haridas Mundhra Scam, Harshad Mehta Scam[10], Ketan Parekh scam, Satyam Scam, Sahara Scam* and *YES bank Scam* had alerted the government and regulators to pass various laws, issue mandatory and voluntary guidelines, establish various committees with a view of promoting and maintaining good corporate governance in the best interests of the corporation and its stakeholders.

Below are some of the landmark cases holding significance of robust corporate governance:

1. Haridas Mundhra Scam:

The Mundhra scam was reportedly the first corporate scam in independent India. Haridas Mundhra, an entrepreneur and stock trader, defrauded the Life Insurance Corporation of India (LIC) of Rs. 125 crore by way of selling bogus shares. The then Prime Minister Mr. Jawaharlal Nehru established a one-man commission headed by Justice Chagla to investigate it. Having proven guilty, Haridas was sentenced to imprisonment for a term of 22 years in jail.

2. The Satyam Scam (2009)[11]:

The Satyam Scam is one of the notable largest one-off corporate frauds in the world, especially in India that rekindled the significance of good corporate governance and robust independent directors, executives and auditors.

The Auditors (Price Water House Coopers from 2000 - 2008), Promoters and Executives of Satyam Computer Services, the fourth largest IT firm listed in India and the US, were the fraud perpetrators. On 07.01.2009, B. Ramalinga Raju, the Chairman and Managing Director of Satyam Computer Services Limited, confessed to fudging of accounts to the tune of Rs. 7,000/- crore. He also admitted that he concealed the fact from directors, auditors, banks, regulators and

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[9] Edwin Sutherland, the American Sociologist, defined white collar crime as ‘one committed by a person of respectability and high social status in the course of his occupation’.

[10] Harshad Mehta was often referred to as the “Big Bull” of the stock market and he was highly criticized for the Indian Stock market crash in April, 1992. He manipulated stock prices of certain companies using fake bank receipts. He manipulated the Indian banking system to siphon off the funds from the banking system and used liquidity to build large positions in selected groups of stocks. He diverted funds to the tune of Rs. 4,000/- crore from the banks to stock brokers. He was later charged with multiple criminal offences.

[11] Refer, *M/S. Satyam Computer Services Limited, vs Directorate Of Enforcement, Writ Petition No.37487 of 2012 & WAMP.No.155 of 2016 in W.A.No.133 of 2013.*

all other stakeholders. To have the reputation of the company intact, the accounts were fabricated for years. The company overstated the cash and bank accounts on the balance sheet and understated the liabilities. The auditors and BoD were to be blamed since they failed to locate it. As per Section 17 of the SEBI Act, 1992, an investigation was conducted and SEBI inspected the books of accounts of the corporation. Due to non-compliance with the standard of auditing, it banned all the firms in the PWC network from auditing the listed companies and intermediaries for a period of 2 years[12]. However, the Securities Appellate Tribunal (SAT) quashed the order of SEBI since the latter has no authority to decide upon the quality of audit standards and services. In 2014, The Serious Fraud Investigation Office (SFIO)[13] ordered a jail term of 6 months for Raju and three other perpetrators. The Court ordered that Raju (along with other perpetrators) be imprisoned for 7 years and imposed a fine of Rs. 5 crore. The investors were panicked since the stock price plummeted in the market. The employees were dreadfully affected. This one-off incident resulted in immeasurable and unjustifiable damage to Brand India and Brand IT in particular. To save India's reputation in the international market, the Government of India came forward and through auction sold the company to Tech Mahindra in April 2009.

3. The Ricoh Case (now, Minosha India Ltd):

The corporate fraud that occurred in Ricoh India Ltd., a wholly owned subsidiary of a Japanese multinational 'Ricoh Company Ltd.', is similar to that of the Satyam Case. The books of accounts of the company were fudged since January 2014 and this accounting fraud led to a net increase of Rs. 199 crore in net profit in the succeeding financial year (i.e. 2014 - 2015). As per the PwC forensic audit (conducted from 1st April 2015 to 30th September 2015) report, it was found that the accounts were fabricated through the account of Fourth Dimensions Solutions Ltd., a supplier and customer.

In January 2015, a concern was raised by an employee of the company stating that the debtors worth more than Rs. 254/- crore were related to customers who had not been delivered goods. The auditors in their report dated 30.09.2015, reported that the company had recognised revenue based on orders in hand which was against the accounting principles of recording revenues on transfer of control of goods to buyers. Consequently, the company admitted the fact that its falsified accounts had led to a financial loss of Rs. 1,123/- crore in the financial year 2015 -

[12] Refer *Section 11 of the SEBI Act, 1992* that empowers SEBI to pass orders to protect the interests of the investors. Also refer, *ibid, Sections 15, 15A-15J* that provide for penalties in cases of insider trading, failure to address investors' grievances, non-disclosure of acquisition of shares and take-over, failure to refund moneys to investors and fraudulent and unfair trade practices and so on.
[13] Refer *Section 211 of the Companies Act, 2013.*

2016.

Without any promoter being in the spotlight, this corporate fraud had occurred in a foreign-controlled company predominantly by dissolute administrators. The main reason behind this could be poor corporate governance for instance, unethical business practices of certain employees of the company, improper internal control mechanisms, non-compliance with the standard accounting principles by the auditor, lack of supervision by the parent company, etc.

4. ICICI Bank Scam[14]:

Mrs. Kochhar was appointed as the CEO of ICICI Bank on 1st May 2009 and reappointed consecutively for a term ending on 31st March 2019. In July 2016, there were news articles alleging nepotism against Mrs. Kochhar regarding the grant of loans to companies associated with Videocon Group / Mr. Venugopal Dhool as a *quid pro quo* for investments by Mr. Venugopal Dhoot or his affiliates in NuPower Renewables Pvt. Ltd. (NRPL), a company promoted by Mr. Deepak Kochhar, the husband of Mrs. Kochhar. On 26th December 2016, ICICI Bank appointed a reputed law firm to conduct an independent enquiry into such allegations and the law firm submitted its report to ICICI Bank stating that there was no merit in the allegations. The Bank informed the law firm that its report would not be valid anymore in light of the new disclosures made by Mrs. Kochhar. On 30.05.2018, the ICICI Bank decided to conduct the enquiry into the allegations made in the 2018 whistleblowers' complaint and informed the same to the Stock Exchange. By that time, she went on leave and while the enquiry was still pending, she applied for early retirement. The bank accepted her early retirement since it did not have adequate knowledge of the facts regarding her misconduct and breaches. Hence, on 30.01.2019, the bank revoked the acceptance of early retirement benefits and sought the RBI's approval to treat the separation of Mrs. Kochhar as 'termination for cause'. The bank terminated her and denied retirement benefits. The CBI arrested Mrs. Kochhar and her husband in connection with Rs. 3,250/- crore Videocon loan scam. On 06.02.2024, the Bombay High Court tagged this arrest as 'illegal' and confirmed an interim order passed in January 2023 by another bench granting them bail.

In this case, the bank had failed the corporate governance test since there was no effective internal control of the ICICI bank to keep a check over conflicts of interest, lack of accountability, transparency and fairness, lack of integrity and ethics, etc. The BoD had also to be blamed for hastily clearing its CEO of any wrongdoings without releasing the findings of an independent enquiry to the public and by declining to answer any questions about the situation.

[14] *Chanda Kochhar v. ICICI Bank Limited, SUIT NO.114 OF 2022, SUIT NO.313 OF 2020.*

5. Kingfisher Airlines and United Spirits Case[15]:

In 2005, Vijaya Mallya launched 'Kingfisher Airlines' which performed critically well in the domestic market mainly due to its luxury and exceptional service. In order to expand his business at an international level, he attempted to acquire 'Air Sahara' in 2006 which was unproductive. Later on, he got permission to operate on the international route by buying 'Air Deccan'. In spite of its successful launch, Kingfisher Airlines started making huge financial losses. He kept on borrowing loans from seventeen different banks, mainly from the Public Sector Banks, to indemnify the losses. The Income Tax Department blocked some of the accounts of Kingfisher Airlines due to non-payment of taxes/tax evasion. The bad phase of Kingfisher Airlines started and consequently, it terribly failed in the market. However, in 2012, it was declared as a Non-Performing Asset (NPI) by the State Bank of India (SBI). Subsequently, its license was cancelled in December 2012. It resulted in immeasurable damage to the stakeholders. In March 2016, he was under charges of financial scam to the tune of Rs. 9,000/- crore (principal amount plus interest). Then to evade the legal proceedings, he flew to the UK in 2016 and since then he has been facing an extradition trial.

In this case, as per the SEBI guidelines, the BoD consisted of both insiders and outside independent directors. However, it was just in letter but not in spirit since the entire control of the company vested with Vijaya Mallya. The employees and the creditors remained unpaid.

It was an obvious fact that the assets had been transferred from United Spirits Ltd. (USL) to finance Kingfisher. While Vijaya Mallya was in charge of the United Breweries (UB) Holdings, it was used as a medium for borrowing funds and offering them to his gathering, inter-corporate credits were granted to related groups without the approval of the BoD, accounts had been inappropriately expressed, reviews had been stage-managed and so on.

The company had also violated several provisions of the 2013 Act. It failed to hold an Annual General Meeting (AGM) for two consecutive years. It failed to submit audited financial statements to the MCA within a stipulated period. There was a significant lack of transparency and accountability. He was charged with several criminal offences related to financial fraud and money laundering.

[15] Dr Vijay Mallya v. State Bank Of India, AIR 2019 KARNATAKA 23, AIRONLINE 2018 KAR 1228; Also refer, Kingfisher Airlines Limited and Dr. Vijay Mallya v. CCI [2010] 4 Comp LJ 557 (Bom); Also refer the Case between Vijay Mallya and Government of India and National Crime Agency, Case No: CO/650/2019.

IV. Conclusion

(A) Findings and suggestions:

- After having traced the history, it is evident that due to poor corporate governance, many corporations have been vanquished and vanished from the competitive market. Hence, the major four pillars of good corporate governance i.e. transparency, accountability, responsibility and fairness must be maintained by the BoD and management of the company for its long survival in the market.
- Many corporate frauds occurred mainly due to the manipulation of the financial statements and lack of the robustness of the internal control systems. The auditors are also one of the significant elements in ensuring a good corporate governance system. Timely and accurate disclosure of the full information of the certified financial results in a transparent manner by the auditors in accordance with the standard accounting and auditing principles is necessary.
- Proper compliance mechanisms must be formulated by the regulatory bodies that facilitate a constant overseeing of the actions of the directors and the executives.
- Corporate frauds are the fallouts of poor corporate governance. The SFIO was established to investigate frauds in the company. Timely fraud reporting and formulating an effective fraud prevention policy by imposing stringent punishment for the offenders will be helpful to curb such frauds.
- The identity of the whistleblower must be concealed and he should be appreciated and protected in such a way as to encourage others to come forward to report the corporate frauds.
- The offenders-cum-fugitives must be punished severely. An International Uniform Code for the Prevention of Fraud could be framed to punish such offenders-cum-fugitives even in their asylum country.
- Further, the appointment of an independent ethical officer, who is free from the influence of any authorities, by all the stakeholders of the company via voting is essential to ensure strict adherence to the code of conduct of the directors and other officials and to protect the interests of the stakeholders.
- The FIIs are keen on investing in the stock market of India followed by the globalisation of the Indian market through the LPG Policy, 1991 and since then the inflow of foreign investments has been considerably in an upward trend. Cross-border investments are

necessary for any corporation to be recognised well in the global market. The FIIs push the companies to strictly adhere to the standards of good corporate governance that curbs corporate failures. Thus, the globally accepted standards of good corporate governance must be incorporated in all Indian companies.

- Effective use of blockchain technology in corporate governance instils confidence in the minds of the shareholders that it acts transparently and therefore, there is no manipulation in decision-making. It ensures proper internal control and further assists in pre-empting the corporate frauds. It also increases the participation of the shareholders in the meetings by enabling the direct and simple exercise of voting rights and thereby, it facilitates them to make decisions in the best interests of the company and the shareholders.

(B) Conclusion

To curb the corporate frauds, the promoters, directors, executives and the employees at different levels of the organization must adhere to the internally adopted voluntary guidelines and the mandatory guidelines framed by the regulators. The internal control mechanisms must be properly implemented and there must be a transparent recruitment process of the managerial personnel whose roles and responsibilities are clearly defined. In case of any violation of the provisions of the 2013 Act or any other law for the time being in force, internal adopted policies of a corporation, fast-tracking the legal proceedings is necessary and the defaulters must be severely punished in no time to protect the interests of the corporation and the stakeholders. The weeding out of offenders and the protection of whistleblowers would encourage others in a corporation to report frauds in a timely manner. It is also noteworthy that mere legislation alone does not ensure sound corporate governance. The best business ethical practices must be adopted by the BoD and the management even during the absence of legislation.

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