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Failure of Corporate Governance and Irregularity Protection to Unlisted Companies

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ABSTRACT

Corporate governance refers to the rules, processes or laws that govern how business run Corporate governance failure refers to situation when a firms management or board of directors failure to uphold their moral and legal obligation to the company and all of its stakeholders including shareholders employees, customer and wider community. Scam teaches the importance of corporate governance White-collar crimes, which include deception, concealment, and breach of trust, are another name for scams. These crimes are typically carried out by business professionals with the intention of making money. Many scams in India like Satyam computers scam, sahara scam, national spot exchange scam, collocation scam etc. After Satyam scam SEBI increased corporate governance standards and number of significant requirements have been included by the Companies Act of 2013 to guarantee excellent governance in line with the international business environment such as Women's Director, Nomination and Remuneration Committee, Independent Director, and Internal Audit tightened financial reporting guidelines and corporate governance requirements for listed publically traded companies in the country. As per clause 49 SEBI monitors and regulates corporate governance of listed companies in India. But in India 90% are either private or unlisted public companies but there is no clause to protect corporate governance for unlisted company and private company. This paper discuss about corporate governance scams in India and also discussed that need to give mandatory clause of corporate governance to protect unlisted companies.

Keywords: *Corporate governance, SEBI, Scams, White collar crime*

I. CORPORATE GOVERNANCE REFORMS IN INDIA

The definition of "Governance" is "a combination of procedures set forth and carried out by the Board of Directors, which are represented in the structure of the organisation and in the way it

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is run in order to accomplish objectives.[3] In India, corporate governance reforms encompassed a variety of additional measures, such as enhanced capital market functionality, efficient safeguarding of minority shareholders, increased transparency and stringent information disclosure requirements, restructuring board structures, and optimising board procedures. In the middle of the 1990s, the Indian government started to change the governance system through laws and institutions. To meet the requirements of sound corporate governance, the Companies Act of 1956 underwent a number of revisions, and the Securities and Exchange Board of India (SEBI) drafted new legislation. In order to make the Act more suited for the times, the Companies Bill 1997, The Companies (Amendment) Act, 1999, The Companies (Amendment) Act, 2000, and The Companies (Amendment) Act, 2001 were introduced.[4] Professional associations, business chambers, and industry associations all made voluntary efforts to advance the reform process. A significant number of reforms were started by SEBI to guarantee improved governance and the growth of effective capital markets. Corporate governance in India will be significantly impacted by the implementation of the K M Birla Committee report's recommendations on corporate governance and SEBI regulations, such as the Buy Back of Securities 1998, Substantial Acquisition of Shares and Takeovers 1997, Takeover Regulation 1997, Employee Stock Option Scheme, and Employee Stock Purchase Scheme Guidelines 1999. Three separate organizations—the Securities and Exchange Board of India (SEBI), the Department of Company Affairs (DCA), and the Confederation of Indian Industry (CII)—developed various governance standards in the late 1990s and early 2000s. The three made proposals for improved governance that were mostly in line with one another and in agreement[5]. The Desirable Code of Corporate Governance, released by the CII in 1998, lists a number of regulations that Indian businesses can implement to comply with global best practises for corporate governance. In order to propose ways to enhance corporate governance in India and create a code of best practises with both mandatory and voluntary clause SEBI established the K M Birla Committee on Corporate Governance in May 1999.SEBI formed another committee Narayana murthy committee in 2002. The Naryana Murthy committee recommended obligatory clauses that, among other things, strengthened the audit committee's duties, managed risks, raised the bar for financial disclosures, clarified the role of nominee directors, and disclosed to

[3] The Chartered Governance Institute UK & Ireland (no date) *What is corporate governance?*, *The Chartered Governance Institute*. Available at: https://www.cgi.org.uk/about-us/policy/what-is-corporate-governance (Accessed: 08 December 2023).
[4] *Chapter - Corporate Governance Initiatives* (no date) *Rajdhanicollege*. Available at: https://rajdhanicollege.ac.in/admin/ckeditor/ckfinder/userfiles/files/Corporate%20Governance.pdf (Accessed: 08 December 2023).
[5] *Reforming corporate governance: Definition, principles & needs* (no date) *Testbook*. Available at: https://testbook.com/ias-preparation/corporate-governance-reforms (Accessed: 08 December 2023).

shareholders the compensation of non-executive directors. To improve corporate governance in India, the Government of India, through Department of company affairs established the J J Irani Committee and the Naresh Chandra Committee. In August 2002, the Naresh Chandra Committee was established to look into a number of corporate governance-related topics.[6] To enhance corporate governance procedures in Indian listed firms, the Ministry of Corporate Affairs (MCA) released the Corporate Governance Voluntary Guidelines in 2009. A number of recommendations were made by the guidelines based on both the mandatory and optional provisions of Listing Agreement Clause 49. Clause 49 is based on Sarbanes –Oxley Act 2002.The primary distinction between the two is that under the Sarbanes-Oxley Act, fraud or the destruction of reports is punishable by up to 20 years in prison; however, this is not the case with Clause 49. SEBI may pursue legal action since it is the market regulator. Should SEBI choose to impose a harsh penalty, it has the authority to initiate legal action or increase the fine for violating Clause 49, which delists the firm automatically.

II. Satyam to rebook failure of corporate governance in India

In many companies they were failure to cope up with corporate governance regulation and leads to corporate governance failure. In India there was huge scam happened 2013 Satyam computer scam and they were lot of corporate governance irregularities and leads to corporate governance failure. After this Scam India also bought lot of regulation to improve corporate governance in India. Background of this scam was B. Ramalinga Raju created Satyam Computer Services Ltd in 1987. The company, which is listed on the NSE, BSE, the New York Stock Exchange, and Euronext, provides information technology (IT) services across multiple industries. [7]The business launched Satyam Infoway ("Sify") in four years, offering back-office outsourcing services to a range of US and European clients. Sify was the first Indian company to be listed on the NASDAQ (National Association of Securities Dealers Automated Quotations) in 1999, when it was functioning in thirty countries. In 2007 satyam computer becomes the official IT service provider for FIFA World cup 2010 in South Africa. Ramalinga Raju was regarded to be one of the most Indian successful businessman across the world. In 2008 company exceeds 2Billion profit and won many distinguished awards. He was awarded with golden peacock award for corporate governance by London council in 2008. The company's downfall commenced at the close of 2008 with Raju's stunning admission that he had fabricated

[6] *Corporate governance in India – practices, framework* (2020) *Deloitte India*. Available at: https://www2.deloitte.com/in/en/pages/risk/articles/governance-101.html (Accessed: 08 December 2023).

[7] Oishika Banerji (2022) *Case study of the satyam fraud case*, *iPleaders*. Available at: https://blog.ipleaders.in/case-study-satyam-fraud-case/ (Accessed: 08 December 2023).

performance data. The World Bank placed Satyam on an eight-year blacklist on December 23 due to allegations of data theft and bribery of bank employees. The company's collapse at the start of 2009 was foreshadowed by Raju's bombshell admission of multiple Satyam manipulations and scams. Following the confession letter, the share price of the corporation dropped by 78%.He inflated cash and bank balance of 5,040 crore[against 5,361 crore] reflected in the books an accrued intrest of Rs376 crore is non existent. Furthermore, there were 40,000 employees rather than the 50,000 Raju claimed, which was 10,000 fewer than the real number of workers. Raju stole $4 million a month from the company's accounts by using fictitious names. He has understated liability to the tune of Rs1,230 crore in accounts of funds arranged by him. He has over-stated debtors position of Rs 490 crore [as against Rs 2,651 crore reflected in the books].[8] The main person responsible for the fraud was Mr. Raju. Indian authorities have charged Mr. Raju and other secondary actors, including the managing director, the chief financial officer, the head of internal audit for the company globally, and Mr. Raju's brother, with fraud. Furthermore, because they were unable to uncover the scam, Satyam's board of directors and auditors also bear some of the guilt. Lastly, the ownership structure of Indian firms made the Satyam situation worse. There were four major issues that led to Satyam’s disgraceful collapse including the independent directors in the company’s board committee, drawbacks in audit, problems with disclosure and transparency, and the failure in CEO/CFO role.

I. Failure of Independent directors

The failure of Satyam was closely associated with the role played by independent directors. These people were supposed to control the company’s activity. However, they did not express either interest or anxiety with the state of things in Satyam. The independent directors had to inquire why the company had so much cash at its disposal, but they never raised such a question. On the contrary, they continued to keep silent for several years. Satyam independent directors were carelessness in their duty.

II. Failure of audit committee

Ensuring that the activities of a firm are transparent and understandable to all stakeholders is the primary responsibility of the audit committee. However, the audit committee failed to carry out its duties in the Satyam case. Such acts did not give a true picture of Satyam's financial situation and ultimately caused the company's control system to fail. The audit committee failed

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[8] https://www.srcc.edu/sites/default/files/Satyam%20scam%20of%20corporate%20governance.pdf

to limit the dissemination of misleading information regarding Satyam's financial affairs.[9]

III. Failure to comply with principles of corporate governance

Principles of corporate governace is transparency, accountability,fairness, responsibility and risk management. Transparency and disclosure of the company's materials are essential for business success since they allow the true status of affairs to be observed and assessed. Neither transparency nor disclosure were offered in the Satyam case. Because Raju's data did not accurately reflect the situation, investors lost a significant amount of money without even realising it. Every piece of information given to stakeholders was false, and nobody realised what was truly going on within the company. Satyam computers fail to comply the principles of corporate governance such as transparency of report, lack of responsibility of Audit committee etc..

IV. Failure of CEO/CFO role

Lastly, Satyam found issues with the roles that the CFO and CEO performed. The CEO or CFO of the company must attest to the veracity and honesty of the financial statements in order for corporate governance regulations to apply. Regretfully, Vadlamani, the CFO, and Raju, the CEO of Satyam, did not carry out their duties effectively. Due to their illicit actions that concealed the actual financial information, the company's stakeholders, investors, and customers were completely unaware of the dire circumstances surrounding Satyam.

Satyam scam can be avoided by some alternative course of action such as dividing the responsibilities, inviting independent supervisors and government intervention. The division of duties would have prevented the company from having one or a small number of people have all the authority and knowledge. Since independent supervisors are more concerned in identifying weaknesses in the organization's functioning than in making personal profits, inviting independent supervisors would have put an end to the fraud schemes. Government intervention would have demonstrated to the business that there is always a power greater than the management of the enterprise. Raju would not have felt so strong and would not have been able to carry out as many unlawful operations in Satyam if the government had shown its interest and control.

Biggest corporate scam after satyam is reebok scam. Reebok international limited a subsidiary company of adidas since 2005 and producer of athletic shoes, apparels and accessories. Adidas

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[9] *Satyam scandal and corporate governance failure - 1939 words: Case study example* (no date) *IvyPanda*. Available at: https://ivypanda.com/essays/satyam-scandal-and-corporate-governance-failure/ (Accessed: 08 December 2023).

of Germany took over Reebok an US brand.Reebok India under Shubinder sing pioneered guaranteed dealers margin to push sales so there was a stand off between new management and Shubinder right from beginning and this led to war. In 2010 Adidas smelt a rat and brought in KPMG to probe into functions of reebok India a report was submitted and found that singh's expense were more than his income. Scam to light in 2012 Subhinder singh dismissed reebok IndiaReebok India has accused its former chief operating officer (COO) and managing director (MD) of committing a fraud totaling Rs 8,700 crore.The business filed a formal complaint with the Gurgaon Police, claiming that the two had established "secret warehouses" and "stolen" goods. Additionally, it has been claimed that the former officials engaged in false sales and manipulated accounts, harming the company to the tune of millions of dollars.Subhinder Singh, the then-MD of Adidas India, was fired from the firm after the alleged scam came to light. Adidas, which acquired the company a few years ago, is the parent company of Reebok. The services of COO Vishnu Bhagat were also terminated.Reebok has stated that when some fraudulent activity was discovered, an internal investigation was conducted."There have been claims of a Rs 8,700 crore fraud

Failure of corporate governance in rebook case

- Fudging company accounts
- Operating secret ware house worth of 870Cr
- Running a false franchise
- Over-invoicing to the tune of 147Cr
- Maintaining 4 secret warehouse where company goods were diverted all of which have been sealed and goods confiscated
- Raising fake invoice of 98Cr to show higher sales and claim promotion, bonus and incentive.[10]

They were several instances of corporate governance failure in India they are,

1. 2018's IL&FS Scandal: Infrastructure Leasing & Financial Services (IL&FS) was a significant infrastructure development and financing firm in India. After the corporation fell behind on its debt payments, it was found that there were a number of anomalies and fraudulent activities going on. The Indian financial system experienced a liquidity crisis as a result of the

[10] *Reebok India claims Rs 8,700 crore scam by former MD, COO; files fir in Gurgaon* (2012) *India Today*. Available at: https://www.indiatoday.in/business/corporate/story/reebok-india-claims-rs-8700-crore-scam-by-former-md-coo-files-fir-in-gurgaon-103065-2012-05-22 (Accessed: 08 December 2023).

scandal.

2.The Nirav Modi scandal of 2018 involved the jewellery and diamond merchant Nirav Modi being charged with defrauding the Punjab National Bank out of over $2 billion. The bank allegedly provided fake letters of undertaking to Modi and his friends, which they then used to apply for loans from foreign banks.

3. CG Power and Industrial Solutions (2019): It was discovered that the power equipment company, CG Power and Industrial Solutions, had committed multiple frauds, including understating obligations, inflating profits, and embezzling money. It was discovered that the board of directors of the corporation had participated in these actions.

4.The Yes Bank scandal of 2020 exposed various irregularities and fraudulent actions committed by one of the biggest private sector banks in India, Yes Bank. Rana Kapoor, the bank's founder, was charged with lending money to businesses in return for bribery. The Reserve Bank of India eventually intervened to save the bank.

The aforementioned cases of inadequate corporate governance highlight the necessity of enhanced regulatory supervision and improved corporate governance protocols in India. The Companies Act of 2013 is one of the steps the government has taken to enhance corporate governance, but much work needs to be done before investor confidence and openness in the Indian corporate sector can be restored.[11]

III. Improvement of corporate governance in India

After Satyam scam our India improved corporate governance regulation. Through the expansion of the Board's duties and obligations, the assurance of investor enthusiasm, the acquisition of a revelation-based administration, and intrinsic prevention through self-direction, the Companies Act of 2013 focuses on excellent corporate governance practises. The 2013 Act modifies the representation of enterprises in a significant way.

The Securities Exchange Board of India's Listing Agreement, Clause 49, provides an explanation of the topic of corporate governance and supports the guidelines that the companies must adhere to. Following the passing of the 2013 Companies Act, Clause 49 of the Listing Agreement was modified by SEBI in an official circular to comply with the new Act.

Clause 49[3] Applies to every listed company with the exception of

Companies with a net value of no more than Rs 25 crore, Companies with equity share capital

[11] LegalMantra (no date) *Thinking ahead*, *Legal Mantra*. Available at: https://www.legalmantra.net/blog-detail/TOP-CORPORATE-GOVERNANCE-FAILURE-IN-INDIA (Accessed: 09 December 2023).

of less than Rs 10 crore,

Following the amendment, clause 49 has laid out principles of corporate governance

1. Board Appointment

The Companies Act of 2013 limits the number of executives that an open and privately held company may appoint to the Board to fifteen. Any business that wishes to appoint more executives must obtain the consent of investors through a special resolution at the General Meeting.In addition, it permits the recommendation of any class or classes of firms to have at least one female executive appointed to the Board of Directors. According to the Act, organisations must have at least one executive who has spent a minimum of a year in the nation.

2. Independent directors

The Companies Act of 2013 defines an independent director in a way that includes most of the posting understanding's characteristics. An independent director need to be a morally upright man with considerable skill and expertise. According to the Act, an independent director's autonomy cannot be influenced by a material financial relationship with the organisation, its executives, promoters, or auxiliaries during the current fiscal year or the following two years. The following provisions for independent directors are included in the Act: Every registered organisation is required by the Companies Act of 2013 to have independent directors make up at least 33% of their total number of directors, with any percentage counting as one.

According to the Companies Act of 2013, an organization's demonstrations of oversight or commission that happened with his insight, as shown by board forms, and with his consent, or in situations where he did not act decisively, will hold an independent director and a non-official executive who is not a promoter or KMP accountable

3. Audit committee

Section 177 of the companies Act of 2013 mandates the requirement of review panels for recorded companies and other recommended classes of organisations. The Act stipulates that the review panel must include three or more heads, with a majority of independent executives. Executives' professional or academic credentials were not included in the 1956 Act. The majority of the Audit Committee members, including the Chairperson, are required under the 2013 Act to be literate in understanding financial articulations.

To increase responsibility and transparency in listed companies, SEBI implemented a number of initiatives.

- Mandatory disclosures

- Stricter auditor regulation
- Tougher enforcement of corporate governance standards
- Higher penalties for non compliance.[12]

4. Members of the Board of Directors

Woman Director: As of April 1, 2015, a listed company's board of directors must have at least one woman director. A required minimum of impartial directors In this case, clause 49 has been reworded to relate to the normal non-executive director instead of the executive director. It further states that at least half of the Board should be made up of independent directors if the Chairperson of the Board is a regular non-executive director who is also a promoter of the company or is related to any promoter or person holding management positions at the Board level or one level below the Board.

5. Policy for Whistle Blowers

The corporation must set up a surveillance system for directors and staff to report concerns regarding once Clause 49 was amended. immoral activity, fraud, whether real or suspected, and a break with the company's ethics policy or code of conduct. Adequate protections against victimisation of those who use this tool to report concerns must also be offered.[13]

According to clause 49, the CEO and CFO must certify to the board that the annual financial statements are prepared in the required manner and that the company has established internal control procedures and systems. Therefore, it is the responsibility of CEOs and CFOs to implement strong internal control and risk management systems for the business processes of their organisations. Internal controls certification has also been made considerably more rigorous by the 2013 Act and amended Clause 49, which included it as a component of the Directors' Responsibility Statement.[14]

The changes to the corporate governance obligations under Listing Agreement Clause 49 are a combination of clarifications and leniencies. The contact that has taken place between SEBI and big corporations is what has revealed the ongoing challenges with interpreting and identifying issue areas under the clause. Considering how realistically corporate governance

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[12] *Satyam Scam and corporate governance: Complete notes for UPSC* (no date) *Testbook*. Available at: https://testbook.com/ias-preparation/satyam-scam-and-corporate-governance (Accessed: 09 December 2023).

[13] Furtado, R. (2019) *Analysis of amendments made to clause 49 of listing agreement of SEBI*, *iPleaders*. Available at: https://blog.ipleaders.in/analysis-amendments-made-clause-49-listing-agreement-sebi (Accessed: 09 December 2023).

[14] *Corporate governance in India – practices, framework* (2020) *Deloitte India*. Available at: https://www2.deloitte.com/in/en/pages/risk/articles/governance-101.html (Accessed: 09 December 2023).

standards may be implemented, this is a positive improvement. Although clause 49 of the listing agreement is now in compliance with the Companies Act of 2013, the path towards smooth implementation standards is not entirely cleared by these adjustments.

Protection to unlisted companies

As per clause 49 it is mandatory to follow corporate governance in all listed companies but in case of unlisted companies there is no mandatory clause to follow corporate governance principles. According to the revised clause 49 implementation schedule, the revised clause 49 will be applicable to all listed firms. On the other hand, for other listed entities such as banks and financial institutions in both the public and private sectors, insurance firms, etc..which are not corporations but rather body corporate. A small number of people frequently own and run private limited corporations, which may present conflicts of interest. It's possible that many investors—especially small investors—do not fully comprehend the significance of corporate governance rules. Consequently, it is essential to inform investors about the value of good governance practises and the ways in which they may safeguard their interests. Well-informed investors take a more active and outspoken role in keeping corporations accountable, which in turn fuels the need for good governance. The inclusion of independent directors enhances decision-making and fosters transparency inside the organisation by bringing in a variety of perspectives and areas of expertise. Even yet, many still struggle to maintain true independence and stay out of conflicts of interest. Therefore, finding and selecting directors who are genuinely independent and capable of offering unbiased advice calls for a concentrated effort. The following are some points about private limited companies' corporate governance, The long-term viability and performance of the business depend on transparent, accountable, and equitable decision-making procedures, which are ensured by good corporate governance practises. It contributes to preserving stakeholders' and investors' trust, which is essential for obtaining capital and upholding a favourable reputation in the industry. It assists in reducing the possibility of fraud, corruption, and other immoral actions that could jeopardise the financial stability and reputation of the business. These are the ways to protect the unlisted and private companies through principles of corporate governance

Recommendation to avoid scams in future

- Companies need to support the moral, ethical, and social values of their CEOs.
- Board members need to be proactive and watchful in defending the interests of owners, and they need to recognise the seriousness of the trust entrusted in them.
- In Satyam's case, timely and reliable information was lacking.

- Activism by shareholders is a powerful tool for controlling a company and its leadership.
- Institutional investors and block-holders can also guarantee that the management and board are held responsible. Lastly, both the letter and the spirit of the CG framework must be adhered to.

IV. CONCLUSION

Satyam's founders' 2009 accounting scam serves as evidence that "human avarice, ambition, and passion for power, money, fame, and glory affect the science of conduct in great part." The Satyam case emphasises the need for securities regulations and CG in developing countries. In fact, the Satyam scam "prompted the Indian government to strengthen the CG regulations in order to avert future occurrences of such scams."Article also discuss that small and private companies should follow principles of corporate governance. Various scams are happening in india the only solution is to follow corporate governance principles. If transparency and accountability are followed in all companies then scams can be avoided in all companies.

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