

## SOME PROMINENT CASES OF FINANCIAL SCAMS AND THE RELEVANCE OF METICULOUS GOVERNANCE SYSTEMS FOR ECONOMIC INSTITUTIONS

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Financial scams remain one of the burning issues in India. India is at the top list of financial scams across the world. No other country can ever compete with India in this regard. The total scam money in India since 1992 till 2009 is approximately 73 Lakh crores (Neerja Gurnani, 2015). Financial fraud investigations involve the following activities;

1. Falsification of financial information of public and private corporations, including:
  - a. False accounting entries and/or misrepresentations of financial condition;
  - b. Fraudulent trades designed to inflate profit or hide losses; and
  - c. Illicit transactions designed to evade regulatory oversight.
2. Self-dealing by corporate insiders, including:
  - a. Insider trading—trading based on material, non-public information—including, but not limited to:
    - i. Corporate insiders leaking proprietary information;
    - ii. Attorneys involved in merger and acquisition negotiations leaking info;
    - iii. Matchmaking firms facilitating information leaks;
    - iv. Traders profiting or avoiding losses through trading; and
    - v. Payoffs or bribes in exchange for leaked information.
  - b. Misuse of corporate property for personal gain

### **The Antecedent of Financial Fraud**

Misgovernance is considered as the root cause of financial frauds across the world. Several companies across the world faced collapse because of corporate frauds. Corporate misgovernance and unethical business practices trouble companies across the world. Corporate frauds have become a global phenomenon. Corporate misgovernance weakens the potential of companies and can pave the way for financial difficulties. If companies are well governed, they will outperform other companies and will be able to attract investors to finance further growth. The major factors that lead to corporate misgovernance are as follows;

### **1. Ownership concentration**

It refers to the amount of stock owned by individual investors and large-block shareholders. A higher level of ownership concentration or more block holders takes stronger monitoring power from other shareholders of the company.

### **2. Undue influence of majority shareholders**

Owners with significant amount of shares may take aggressive actions, either directly or indirectly, over company decisions such as the election of board members and replacement of CEO or poor management with their voting power.

### **3. Lack of capable independent directors**

Independent director means a director who has not been employed by the company or its related parties. He agrees to serve the company as a nonexecutive member of the board as a truly independent director. But lack of independence and capability of the independent directors is a major factor leading to misgovernance of many companies.

### **4. Lack of transparency**

Concealment and non-disclosure of material facts related with the company is another cause of misgovernance. Boardrooms of many companies are like black boxes covered in mystery and untouchable by media, investor and stakeholder enquiry.

### **5. Related party transactions**

Interests of the shareholders are adversely affected when related parties take undue benefits out of deals and contracts with the company. This is a common case of misgovernance in many companies.

## **Some Cases of Economic Frauds in India in the Corporate World**

The following are the selected cases of financial frauds in India in the corporate world;

### **Case of Satyam Computer Services Ltd.**

The Satyam Computer Services scandal occurred in 2009 where the Chairman of the company confessed that its accounts had been manipulated by US\$1.47 Billion, over Rs.7800 crores. Profits were inflated, understated liability and overstated debts. The market price of Satyam shares was slashed to Rs. 11.50 in 2009 as against Rs. 544 in 2008 as a result of this scam. Pricewaterhouse Coopers was the statutory auditor of the company during the period of the scandal. U.S. Securities and Exchange Commission fined PricewaterhouseCoopers for \$6 million for not following the code of conduct and auditing standards while auditing the accounts of the company. The annual report (2007- 08) of Satyam Computer Services Ltd., stated that “The Company’s goal is to find creative and productive ways to delight its stakeholders. Thereby fulfilling the role of a responsible corporate representative committed to best practices.” But the later events showed a clear case of corporate misgovernance. The company falsified its accounts and diverted huge amount of funds. The company was later purchased by Tech Mahindra.

### **Case of WorldCom Inc. in U.S.**

WorldCom Inc., a Telecommunications Company was at one time the second-largest long distance phone company in the U.S. On June 25, 2002, WorldCom announced that it had overstated earnings in 2001 and the first quarter of 2002 by more than \$3.8 billion. The company announced that it had also manipulated its reserve accounts. The U.S. Securities and Exchange Commission (SEC) charged the company with massive accounting fraud and quickly obtained court order barring the company from destroying financial records, limiting its payments to past and current executives, and requiring an independent monitor.

### **Case of Enron Corporation**

Enron Corporation was an American energy company based in Houston, Texas. Enron shareholders filed a \$40 billion law suit after the company's stock price, which achieved a high of US\$90 per share in mid- 2000, fallen to less than \$1 by the end of November 2001. The company filed for bankruptcy protection in 2001 as a result of a huge scandal. The company adopted a great deal of falsification in its accounts to indicate favourable performance. Enron scandal is a well-known example of corporate misgovernance.

### **Plantation Companies Scam**

Plantation company scam took place in India in 1999. Companies collected around 5000 crores from people and misappropriated the money. To attract investors and to win their confidence, companies evolved various promotional strategies. Catchy plantation advertisements in newspapers and magazines, promising high returns - Rs 50,000 and more in a couple of decades against the purchase of trees at a nominal cost, varying from Rs 495 to Rs 2,500.

### **Case of Vanishing Companies**

The Capital Market Boom of early 1990s in India witnessed a large number of companies raising money through public issues vanished with the investors' money. 3911 companies that raised over Rs.25, 000 crores vanished or did not set up their projects. The Ministry of Corporate Affairs, Government of India published a list of vanishing companies in the country.

### **Ketan Parekh Securities Scam**

Ketan Parekh bought huge holdings in lesser-known small-cap firms and jacked up their values through collaboration with these companies and large institutional investors, as well as through circular trading with other traders. As a result, stock values skyrocketed. It was later discovered that companies frequently provided Parekh cash in order to artificially inflate the value of their stock. Thus, shares of totally unknown firms like Visualsoft went from Rs 625 to Rs 8,448 per share in just a few months, while Sonata Software rose from Rs 90 to Rs 2,936.60 per share. Parekh had been involved in circular trading from and with a range of entities over the time period, including Global Trust Bank (GTB) and Madhavpura Mercantile Cooperative Bank, according to a 30-member Joint Parliamentary Committee (JPC) probe. From 1995 to 2001, the JPC judged him to have had a key role in manipulating the prices of ten Indian enterprises.

### **Saradha Group Chit Fund Scandal**

It was a major financial scam and political scandal arised from the collapse of ‘Ponzi scheme’ run by Saradha Group, a consortium of over 200 private companies. The company had mobilised around 200 to 300 billion (US\$4–6 billion) from over 1.7 million depositors. The State Government of West Bengal set up a support of 5 billion (US\$66 million) to protect the victims of the scam.

### **Punjab National Bank Scam**

The Punjab National Bank scandal relates to fake letter of undertaking for Rs 10,000 crore issued by the bank. The key charged within the case were jewel dealer Nirav Modi, his uncle Mehul Choksi, and other relatives and a few PNB staff. Nirav Modi and his relatives gotten away India in early 2018, days some time recently the news of the scandal got to be open. PNB scandal has been considered as the greatest extortion in India's banking industry.

### **Karvy Stock Broking Limited (KSBL)**

The National Stock Exchange declared Karvy Stock Broking Restricted (KSBL) as a defaulter for non-compliance of the rules and regulations and ousted it from the membership. SEBI had evaluated that Karvy unauthorisedly transferred Rs 1,096 crore to its real estate business by misusing the PoAs (Power of Attorney) of its clients.

### **The Need of Efficacious Corporate Governance Systems to Curb Frauds**

A solid mechanism of corporate governance is a hot topic of discussion in the modern corporate world. The reason for such an importance to this topic is continuing cases of financial scams and conflicts between the owners and controllers of corporations. Mismanagement and misgovernance are the two bottlenecks that trim down the competitive edge of the companies worldwide. A disciplined corporate environment cannot be achieved only by way of imposing rules and regulations. Fiduciary responsibility, industrial espionage, ethics, accountability, fairness, integrity, transparency and disclosure are not certain principles that are to be preached but are to be practiced in companies at their own free will. The voluntary involvement and commitment of all the parties concerned are inevitable for ensuring good governance in companies.

A business that pays no attention to moral values and principles in its operations is considered as a poor business. Corporate governance recognizes the importance of ethics and social responsibility in the management of a business. It is based on the principle that business is accountable for its actions and therefore every business is required to establish certain guidelines, principles and moral standards to govern its operations. It provides a structure through which the objectives of a company are set and how they are achieved and monitored. The role of corporate

governance is setting right goals, selecting right paths, making right decisions and doing right actions so as to ensure honesty and fairness in business operations. Corporate governance defines relationships between a company's management, its board, shareholders and other stakeholders. Corporate governance is a set of processes, practices, policies and laws affecting the way a business is directed, managed or controlled. It is a structure of rules, relationships, systems, programmes and processes within the business and by which authority is exercised and controlled in the organisation.

The Organisation for Economic Co-operation and Development (OECD) defines corporate governance as “procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation such as the board, managers, shareholders and other stakeholders and lays down the rules and procedures for decision-making.”

### **Core Principles of Good Corporate Governance**

There are some commonly accepted key principles or elements of good governance that are applicable to all organisations;

- **Openness and transparency**  
Good governance ensures openness and transparency so as to give the stakeholders true and fair information about the operations of the organisation.
- **Accountability**  
Good governance ensures that all members of the organisation responsible and accountable for their decisions and actions.
- **Integrity**  
Good governance ensures straightforward dealing based on honesty and objectivity. It also includes observing high standards of probity and propriety in the functioning of the organisation.
- **Effectiveness**  
Good governance ensures that the organisation generates and delivers quality outcomes efficiently so as to give maximum benefits to the stakeholders.

### **Mechanism of Good Corporate Governance**

Good Corporate governance sets guidelines for monitoring the performance of the organisation. It addresses the need of the organisations to act in the best interest of the firm's core stakeholders. It guarantees that the shareholders receive a fair return on their investment through good performance. It would insist for compliance with legal requirements,

industrial standards and accountability to the stakeholders. It is to meet the requirements of the law, regulations, published standards and community expectations of honesty, accountability and openness. Good governance would facilitate companies to establish right goals, selecting right ways, making right decisions and doing right actions so as to ensure honesty and fairness in their operations. Good governance aims at ensuring a fair and equitable treatment of shareholders without any discrimination. In some organisations, a particular group of shareholders enjoy more power and benefits due to their strong position and may be better able to guard their interests. Such groups include high net-worth individuals and institutions that have a substantial proportion of the share in the company. Equal treatment of all shareholders and the protection of shareholder rights are the two important areas of corporate governance.

Corporate governance accepts the diversity of people in the workplace. It ensures equal opportunity in all aspects of employment regardless of race, color, religion, sex, nationality, age, marital status, disability, or any other basis. Good governance systems would check fraud and corruption in business. It would take high initiatives to promote integrity, co-operative behavior and responsibility towards community and the society. It aims at ensuring a higher degree of transparency in an organization by encouraging full disclosure of transactions in the company accounts. Full disclosure includes compliance with regulations and disclosing any information important to the shareholders

In a broader perspective, corporate governance is much more than improving internal company environment and procedures. It encompasses a wide variety of tools that also address the environment within which companies operate, i.e. issues associated with the development of the nation. Corporate governance is fundamental to changing the relationship between business and the society. It helps to remove corporatism, and corruption. Corporatism is the act of lobbying government officials and even co-opting a government. Corporate governance injects transparency into the operations of a business and helps the nation to attract investments for economic growth, job creation, and poverty alleviation.

Good governance helps companies and countries to search for investment, improving competitiveness, and gaining access to regional and international markets. Corporate governance in the broader sense contributes to the sustainable development prospects of countries, increased economic sustainability and institutional reforms. Failures in corporate governance weaken development efforts of a nation as a result of misallocation and misuse of scarce capital and resources. Problems in corporate governance undermine job and wealth creation and may lead to destabilization of the economy.



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