Analysis of Corporate Frauds in India from ethical perspective

ISBN: 978-81-924713-8-9

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Business ethics is of paramount importance as many top organizations are continued to be marred by plethora of scandals and frauds. Corporate frauds result in loss of market capitalization and brand image of the organizations. They are alarmingly prevalent across countries, and across sectors of the economy. This conceptual paper highlights some of the major corporate frauds since independence and their repercussions on social and economic fabric of India. Keeping sustainability as a fulcrum, it attempts to suggest steps that companies can and must adhere for running their businesses ethically and thereby minimizing, if not eradicating the corporate frauds.

Key words: Corporate Frauds, Sustainability, Business Ethics.

1. Introduction

Section 17 of the Indian Contract Act defines "Fraud" as

"Fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto his agent, or to induce him to enter into a contract.

Corporate Fraud as defined by CIMA (Chartered Institute of Management Accountants) is 'a type of fraud that essentially involves using deception to make personal gain for oneself dishonestly and/or create a loss for others'.

To better understand frauds we can look at it from different views. For example, we can look if a fraud is internal or external to the organization that was involved or had gotten involved with fraudulent acts. Almost 75% of corporate surveyed in India felt the overall incidence of fraud was raising. For the coming years, E-Commerce and computer related frauds would be of a major concern. (India Fraud Report Survey, 2010, KPMG).

In India, corporate frauds have a long, chequered history. Ethics have been a grey area in Indian companies for decades. According to a case study by IBS Case Development Center, corporate fraud is a major area of concern with almost 42 per cent the companies experiencing it, incurring a direct loss of $1.5 million. The suppliers' kickback, it says, is the most prevalent form of fraud. Companies have put in place a slew of measures - employee registry, biometric identification, background check - to deal with the scourge of corporate frauds. Corporate frauds in India have witnessed a sharp climb in past two years, and ironically enough, companies consider it inevitable. This trend, according to a global consultancy firm KPMG's biennial, 'India Fraud Survey 2012' is 'dangerous' as it forces organizations to exhibit a tolerant approach towards the cases of fraud. "Close to 55 per cent of respondents indicated that their organizations experienced fraud in the last two years vis-a-vis 45 per cent in 2010 edition of our survey," the report said. In March 2012, Ernest & Young (E&Y) carried out its first survey of corporate fraud in India titled 'Fraud and Corporate Governance: Changing Paradigm in India'. The survey highlighted the callousness of top leadership in Indian companies and their willingness to sweep things under the carpet. Only 35 per cent of respondents said their employers take legal action against fraudsters.

"Companies typically prefer to avoid reporting any economic offence to a regulator because of a perceived threat to their reputation," concluded the survey report.

Over the years, as the competition has got fierce, the organizational structure has become increasingly decentralized, leading to weak internal control within organizations. It has in turn spurred the incidence of big and small corporate frauds. There is a growing feeling that early detection is critical in combating this menace. According to PWC survey, 99 per cent of the respondents have incorporated internal controls, internal and external audits, compliance programmes and code of ethics to control fraud. Corporate frauds in India have witnessed a sharp climb in past two years, and ironically enough, companies consider it inevitable.

The scale and size of corporate frauds in India have zoomed in the last 15 years with over half the cases of fraud dealing with siphoning of funds by promoters/top management and defrauding the lenders.

This conceptual paper will look at some of the major corporate frauds in India and its ethical implications.

2. Methodology

14 major frauds of India from the time of independence have been viewed for this conceptual paper and the conclusions are based on the ethical lessons learned from the same.
Following are the 14 frauds taken into consideration:

1) Mundhra Scam

2) Satyam Scandal
3) Bofors Scams
4) 2G Spectrum Scam
5) Harshad Mehta Scam
6) Ketan Parekh Scam
7) Citibank Fraud
8) IPL Scam
9) Telgi Scam
10) Antrix Devas Deal
11) HBN Dairies & Allied Ltd Scam
12) Potato purchasing rackets of Sunangal Industries
13) SCHIL (Stock Holding Corporation of India) Scam
14) Austral Coke in Rs.1000 cr a/c Scam

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4. Big Corporate Frauds in India

Mundhra Scam

This was the first scam of independent India. Haridas Mundhra, an industrialist and stock speculator sold fictitious shares to LIC and thereby defrauding LIC by Rs.125 crores. Mr.Jawahar Lal Nehru, set up a one-man commission headed by Justice Chagla to investigate. Justice Chagla concluded the matter; Haridas was found guilty and was sentenced to imprisonment for 22 years.

Satyam Scandal

The biggest corporate scam in India came from one of the best known businessmen. Satyam founder Byrraju Ramalinga Raju resigned as its chairman after admitting to cooking up the account books. His efforts to fill the "fictitious assets with real ones" through Maytas acquisition failed, after which he decided to confess the crime. With a fraud involving about Rs 8,000 crore (Rs 80 billion), Satyam remains one of India's biggest ever corporate scams.

The astounding confessions of B. Ramalinga Raju, ex-Chairman of Satyam Computers, has not only hit investors and employees badly, it has also tarnished the reputation of India's IT sector. Amidst fears that clients would do a rethink on business commitments, the bigwigs of India Inc are desperately trying to paint the Satyam case as an exception. While Indian corporations really need to do everything possible to salvage the situation, they also must pay heed to some lessons to be learnt from the scandal.

Why would Satyam have been tempted to break the law?

1. Post 1990, in what is known as the liberalization period, the corporate sector has played a major role in the Indian economy.
2. There must have been times when the increasing competition forced big corporations to seek unethical ways of conducting their business.
3. Ramalinga Raju might have been tempted to spice up Satyam's account to show the company's performance in good light. Infosys, Satyam's competitor, has been recording tremendous growth over the years. Even after the Satyam scandal became public news, Infosys' performance remained largely unaffected.

4. It could also have started off as an attempt to cover up the bad performance in one quarter. As Raju admits in his letter, what was initially a small gap between the actual and reported operating profit, became unmanageable as the company expanded.
5. Overconfidence in his ability to turn things around before they got out of hand could have been another compelling reason.

Bofors Scam

The Bofors scandal is one of the biggest scam that cripples India. The Bofors scam was a major corruption scandal in India in the 1980s and brought a major setback Gandhi's ruling Indian National Congress party. The then PM Rajiv Gandhi and several others including a powerful NRI family named the Hindujas, were accused of receiving kickbacks from Bofors AB for winning a bid to supply India's 155 mm field howitzer. It has been speculated that the scale of the scandal was to the tune of ₹ 400 million. The case came to light during Vishwanath Pratap Singh's tenure as defense minister.

The name of the middleman associated with the scandal was Ottavio Quattrocchi, an Italian businessman who represented the petrochemicals firm Snamprogetti. Quattrocchi was reportedly close to the family of Prime Minister Rajiv Gandhi and emerged as a powerful broker in the 1980s between big businesses and the Indian government

2G Spectrum Scam

At a mind-boggling Rs 176,000 crore (Rs 1.76 trillion), the 2G spectrum allocation scam is by far the biggest scam in India. The Supreme Court recently said the spectrum scam has put 'all other scams to shame'. The incident saw former telecom minister A Raja being forced to resign after the CAG indicted him in the 2G spectrum scam that resulted in a loss of about Rs 176,000 crore to the national exchequer. Even as investigations in to the scam -- which has now become a political hot potato with the Opposition gunning for the government, demanding a JPC and the ruling UPA adamant on not giving in -- are on, it has come to light that politicians, corporate lobbyists, business houses and even the media might have played a big role in it. The scandal revolves around the alleged irregularities in allotting wireless radio spectrum and licenses by the telecom ministry to private operators -- some of whom were ineligible -- in 2007. Licenses were given and spectrum allocation was done at an extremely low price leading to a gargantuan loss to the national coffers.

Harshad Mehta- Stock Market Scam

He was known as the 'Big Bull'. However, his bull run did not last too long. He triggered a rise in the Bombay Stock Exchange in the year 1992 by trading in shares at a premium across many segments. Taking advantages of the loopholes in the banking system, Harshad and his associates triggered a Securities scam diverting funds to the tune of about Rs 5,000 crore (Rs 50 billion) from the banks to stockbrokers between April 1991 to May 1992. Harshad Mehta worked with the New India Assurance Company before he moved ahead to try his luck in the stock markets. Mehta soon mastered the tricks of the trade and set out on dangerous game plan. Mehta has siphoned off huge sums of money from several banks and millions of investors were conned in the process. His scam was exposed, the markets crashed and he was arrested and banned for life from trading in the stock markets. He was later charged with 72 criminal offences.

Ketan Parekh- Stock Market Scam

Ketan Parekh followed Harshad Mehta's footsteps to swindle crores of rupees from banks. A chartered accountant he used to run a family business, NH Securities. Ketan however had bigger plans in mind. He targeted smaller exchanges like the Allahabad Stock Exchange and the Calcutta Stock Exchange, and bought shares in fictitious names. His dealings revolved around shares of ten companies like Himachal Futuristic, Global Tele-Systems, SSI Ltd, DSQ Software, Zee Telefilms, Silverline, Pentamedia Graphics and Satyam Computer (K-10 scrips). Ketan borrowed Rs 250 crore from Global Trust Bank to fuel his ambitions. Ketan along with his associates also managed to get Rs 1,000 crore from the Madhavpura Mercantile Co-operative Bank. According to RBI regulations, a broker is allowed a loan of only Rs 15 crore (Rs 150 million). There was evidence of price rigging in the scrips of Global Trust Bank, Zee Telefilms, HFCL, Lupin Laboratories, Aftek Infosys and Padmini Polymer.

Citibank Fraud

The modus operandi of frauds on wealth management at CITI Bank, Gurgaon has unraveled how combinations of greed and promise of higher returns has facilitated the relationship manager to manipulate the system and expose the NRIs and Corporates to the risk of losing their money. The customers were promised high returns by misrepresenting a nonexistent SEBI circular. The investors were driven by greed of higher return and therefore easily influenced by the relationship manager to act according to his direction. The funds were diverted to the security market and used for derivative transactions without hedging the downside risk. Once the market moved against the leveraged positions, the margin calls were triggered which resulted in the inevitable.

IPL Scam

India who proudly boasts over its frenzy created by IPL 20-20 cricket also carries the same of a scandal with IPL. It started when IPL Commissioner Lalit Modi revealed that Tharoor's friend Sunanda Pushkar had equity stakes in Rendezvous Sports World (RSW), heading the consortium that owns the Kochi team. It was later disclosed that Pushkar got sweat equity of the value of Rs 70 crore. Shashi Tharoor maintained that the amount had nothing to do with his active campaigning and mentoring for the Kochi team. This was less convincing as he had specifically mentioned that he had no specific gains from RSW winning Kochi Franchisee. Income Tax investigation report into match-fixing angle in the IPL revealed Lalit Modi has interests in three teams.

Telgi Scam

One of the most dramatic scams in India, Abdul Karim Telgi was the mastermind behind the whole idea of printing forged duplicate stamp papers that made its way into the banks and other institutions. Estimated at a massive cost of Rs 20000 crores, the fake stamp paper and stamp had infiltrated 12 states.

Reports also suggest that the kingpin had government backing which was held responsible for the selling and production of high security stamps. In Telgi Scam a lots of investigation was done and get big headlines in this news.

Antrix Devas Deal

In 2011, G Madhavan Nair former ISRO chairman and three other scientists were responsible for a controversial deal between the Indian Space Research Organization’s (ISRO) commercial arm Antrix Corporation and Devas Multimedia. The deal involved ISRO leasing the S-band transponders on two satellites (GSAT6 and GSAT6A) to Devas for broadcasting purposes.

A CAG report found that the department of space hid facts from the cabinet and violated rules and policies in approving the agreement. The report’s leak fired a controversy that free spectrum was being given. The CAG audit reported that there was a loss of Rs 200,000 crore.

Cattle & Ghee Racket: HBN Dairies & Allied Ltd

Here is another racketeer company which collected Rs. 1,100 crore (Rs. 11 billion) from public on the promise of high returns within a short span.

The company had succeeded through the 'agents' to hoodwink people that it is a profitable venture and people believed it blindly.

People had already invested Rs. 745 crore in the company's 'Cattle and Ghee' scheme with the hope of getting huge returns. By March 31, 2011, it had collected Rs. 745 crore from public and after that also it continued the collection. Though it has yet to be ascertained how much the company had actually collected from public it is estimated that it would be Rs. 1,100 crore. The SEBI has issued restrictions on the company which prohibited selling of its properties worth Rs. 1,000 crore in addition to the deposits collected by the company. The SEBI has also instructed the company to prepare an action plan to refund the Rs. 1100 crore deposits to the public within thirty days.

Potato-Purchasing Racket of Sumangal Industries

Kolkata-based Sumangal Industries started yet another racket with the lure of big returns in short span. The company in question asked deposits from people with the promise of 100 per cent returns in 12 months.

The company promised to invest in potato purchases in large scale and sell the same with huge profits. It had collected several crores of rupees from those who believed them. However, the Securities & Exchanges Board of India put a spanner in the racket of Sumangal Industries and asked it to return the amount in three months to all the investors.

Schil Scam

SHCIL is India's largest Custodian and Depository Participant (DP), with almost every top public sector financial institution as its client and shareholder. SHCIL bagged a prestigious contract for electronic stamping of revenue documents as part of the post-Telgi move towards paperless stamping. SHCIL was to be the record-keeping agency for this Rs 50,000 crores market that is growing rapidly. It tied-up with Singapore-based CrimsonLogic for the technology and arranged to route its payments through two entities, the last of which was set up in Singapore by SHCIL's professional managers. The mischief of SHCIL's management has to be seen in the context of the potential damage and losses that their actions could have caused. It had the potential of being a sequel to the Telgi scam, but was exposed before the damage was done and prevented by quick government action.

Austral Coke Scam

The scam was unearthed in Ahmedabad by the Income Tax Department following searches conducted on June 23, 2009. On a day when Austral Coke & Projects said it has acquired 50% stake in Osho Gremach Mining Limitada in Mozambique, the Securities and Exchange Board of India (Sebi) has found the company involved in a Rs 1,000 crore accounting scam. The manufacturer of low-ash metallurgical coke manipulated books by showing fraudulent purchases and sales to 29 companies associated with Kolkata-based Ajit Kumar Jindal, the capital markets regulator said on Tuesday. The scam was unearthed in Ahmedabad by the Income Tax Department following searches conducted on June 23, 2009. The taxmen found bogus purchases of Rs 553 crore and sales of around Rs 495 crore. Jindal has admitted they were sham transactions.

5. Analysis of the Corporate Frauds Committed

After looking at the above cases we first look at who is responsible for these frauds and have arrived at the conclusion that everyone from the Board of Directors, CEO, CFO, Senior Management, Internal Auditors, the IT Department, Middle Management and Operational Management are deeply involved and are responsible.

The causes and the solutions alike can be rooted to the following 5 major categories:

1) Personal Ethics
2) Decision Making Processes
3) Organizational Culture
4) Unrealistic Performance Goals
5) Leadership

First, business ethics are not completely different from personal ethics which are the generally accepted principles of right and wrong governing the conduct of individuals. Our personal ethical code exerts a profound influence on the way we behave as businesspeople. It follows that the first step to establishing a strong sense of business ethics is fir a society to emphasize strong personal ethics.

Many studies of unethical behavior in a business setting have concluded that sometimes corporate do not realize they are behaving unethically primarily because they simply fail put a thought if the decision that they have made is ethical or not. The fault lies in the processes that don't incorporate ethical considerations into business decision making.

One of the major causes of corporate frauds is that most organizational cultures have been deemphasizing business ethics (as seen in the cases above), thus reducing all decisions to the purely economic level. Values and norms shape the culture of a corporate entity, and culture had an important influence on the ethics of business decision making.

Unrealistic performance goals and pressure from the parent company, the economy and the society at large which can be attained only by cutting corners or acting in an unethical manner contribute to a large extent of the corporate frauds (main case: Satyam).

But the main root of all lies in the leaders of the corporate entity. Leaders help establish the culture of the organization, and they set the examples that others follow. Other employees in the corporate often adopt and adapt to the methodology or behavior that the leaders enact and if the leaders don't behave in an ethical manner, there is a major chance the employees of the corporate will not either.

Lessons that can be learnt

An organizational culture can legitimize behavior that the society would judge as unethical, particularly when it is mixed with a focus on unrealistic performance goals, such as maximizing short term performance, no matter what the costs. In such situations, there is a greater than average chance that the middle level managers will violate their own personal ethics and engage in unethical behavior.

Some Legal Solutions

Business Ethics and Whistle-Blowing

It is a widely recognized fact that efficient corporate governance is rooted in the ethical behavior of the top leadership in the organization. One of the important ways of introducing a culture of ethics and values is a whistle blower policy. The Securities and Exchange Board of India (SEBI) mandates a whistleblowing mechanism in Clause 49 of the Listing Agreement that deals with corporate governance norms. In effect since 2003, however, it has not been as helpful as desired.

The Public Interest Disclosure Bill, 2010, has further augmented the awareness about whistleblowing activities and the need to provide adequate protection to whistleblowers. But, there is still a lot of work to be done to prevent or detect the increasing cases of corporate fraud. A report by Singapore Press Holdings Limited reveals that almost half of the Asia-Pacific companies are confident of their internal fraud controls. However, according to a report by PriceWaterhouse Coopers, only 16 per cent of economic crimes in the region are detected by risk-management systems. The vast majority of incidences of economic crime, says the report, are detected by accident, tip-off, internal and external audit.

Suggestions for the Way Ahead

Hiring and Promotion

Companies can give potential employees psychological tests to try to discern their ethical predisposition, and they can check with their prior employees regarding someone's reputation. (The latter is already a common practice.)

Not only should firms try and hire people with strong sense of personal ethics, but it is also in the interest of the prospective employees to find out about the ethical climate of the firm that they are going to join.

6. Organizational Culture and Leadership

Firms must explicitly articulate values that emphasize ethical behavior. Many firms do this now by drafting a **Code of Ethics** which is a formal statement of the ethical priorities that the business adheres to and the Code of Ethics draws heavily upon documents such as the UN Universal Declaration of Human Rights, which is grounded in Kantian and rights-based theories of moral philosophy. For example, according to Unilever's code of ethics it does not tolerate substandard working conditions, use child labor or give **bribes** under any circumstances. It also refers to respecting the dignity of employees, a statement that is grounded in Kantian Ethics.

Leaders in the firms must give life and values to those words by repeatedly emphasizing the importance of ethics and then acting on them, meaning, using every relevant opportunity to stress the importance of business ethics and making sure the key business decisions not only make good economic sense but are also ethical. For example, at GE, former CEO Jack Welch has described how he reviewed the performance of managers, dividing them into several groups. This included over performers who displayed the right values and were singled-out for advancement and bonuses and over performers who displayed the wrong values and were let go. He was not willing to tolerate leaders within the company who didn't act in accordance with the central values of the company, even if they were in all other respects skilled managers.

7. Ethics Officer

To make sure that a firm behaves in an ethical manner, a number of firms now have ethical officers. These individuals are responsible for making sure that all the employees are trained to be ethically aware, that ethical considerations enter the business-decision making process, and that the company's code of ethics is adhered to. Ethics officers may also be responsible for auditing decision making to make sure they are consistent with this code. They also act as internal ombudsman person with responsibility for handling confidential inquiries from the employees, investigating complaints, reporting findings and making recommendations for change. Example, some Tata group companies like Tata Sons, Tata Steel and Tata Teleservices are among the few which have ethics officers in India. For instance Tata Sons, the main holding company of the group, in February appointed Mukund Rajan as chief spokesperson, brand custodian and chief ethics officer for the group.

8. Summary

Corporate frauds represent social and economic liability. The failing ethical values both at the individual and organizational levels are root cause of this tragic malady. A deep social revolution touching the core of human hearts and a strong leadership capable enough to infuse discipline at all levels can be the panacea for getting out of the rot. Infusing innovative technology tools to arrest the white color frauds are the necessity of the day. Organizations are needed to nurture and promote ethical culture in the organizations apart from subjecting themselves to ethical audit at periodical intervals.

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