Global Journal of Management and Business Research: G Interdisciplinary
Volume 16 Issue 1 Version 1.0 Year 2016
Type: Double Blind Peer Reviewed International Research Journal
Publisher: Global Journals Inc. (USA)
Online ISSN: 2249-4588 & Print ISSN: 0975-5853

Strategies that Led to Failure - Case Study of Corporate Governance

By Dr. Navita Mahajan

Abstract- The case study is about Corporate Governance and its failure in India. We consider the corporate governance to be the main element when we have to talk about the success of a company but at the same time if it fails due to different reasons such as, the financial, social and political reasons, the consequences can be very serious. In order to understand the importance of this system we have tried to explain and define the notion of corporate governance being inspired by the studies already made in this field. In the second part of the paper we pointed out the benefits that a company enjoys when good corporate governance practices are embraced. In the third part we highlighted the principles and the models of corporate governance. In the fourth part of the paper we focused out attention on some resounding financial scandals from all over the world and then analyzed the causes that led to failures. Towards the end, we took a close look at the failure in corporate governance and tried to analyse the reasons that lead to failure.

Keywords: corporate governance, principles, failure, scandals, stakeholders.

GJMBR - G Classification : JEL Code : G34

STRATEGIESTHATLEDTOFAILURECASESTUDYOFCORPORATEGOVERNANCE

Strictly as per the compliance and regulations of:

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I. Introduction

Corporate governance begins with power who holds the power in an organization, how it is delegated and exercised, its purpose, and what control mechanisms the power holders use. With power comes the responsibility of decision making, the right to choose, and the option to delegate. Power in a company is not absolute because it is always exercised within guidelines or constraints. In public corporations, the purpose of power is the creation of value, and the structure of shareholder owned corporations means that the value created must be shared. Therefore, a comprehensive definition of corporate governance will cover all the activities involved in creating and sharing value.

II. Factors Influencing Corporate Governance

a) The ownership structure

The structure of ownership of a company determines, to a considerable extent, how a Corporation is managed and controlled. The ownership structure can be dispersed among individual and institutional shareholders as in the US and UK or can be concentrated in the hands of a few large shareholders as in Germany and Japan. But the pattern of shareholding is not as simple as the above statement seeks to convey. The pattern varies the across the globe.

Our corporate sector is characterized by the co-existence of state owned, private and multinational Enterprises. The shares of these enterprises (except those belonging to a public sector) are held by institutional as well as small investors.

Specifically, the shares are held by:

1) The term-lending institutions.
2) Institutional investors, comprising government-owned mutual funds, Unit Trust of India and the government owned insurance corporations.
3) Corporate bodies.
4) Directors and their relatives, and
5) Foreign investors

Apart from these block holdings, there is a sizable equity holding by small investors.

b) The structure of company boards

Along with the structure of ownership, the structure of company boards has considerable influence on the way the companies are managed and controlled. The board of directors is responsible for establishing corporate objectives, developing broad policies and selecting top-level executives to carry out those objectives and policies.

c) The financial structure

Along with the notion that the structure of ownership matters in corporate governance is the notion that the financial structure of the company, that is proportion between debt and equity, has implications for the quality of governance.

d) The institutional environment

The legal, regulatory, and political environment within which a company operates determines in large measure the quality of corporate governance. In fact, corporate governance mechanisms are economic and legal institutions and often the outcome of political decisions. For example, the extent to which shareholders can control the management depends on their voting right as defined in the Company Law, the extent to which creditors will be able to exercise financial

Author: e-mail: nmahajan@amity.edu

claims on a bankrupt unit will depend on bankruptcy laws and procedures etc.

III. Corporate Governance Failure in India

a) Reebok India case

Agencies probing the alleged Rs 870 crore corporate fraud in the operation of Reebok India have detected a systemic "mismanagement" in the business planning and governance of the company reportedly done by some of its officials and employees.

Three different agencies -- the I-T department under Finance Ministry, the Serious Fraud Investigation Office (SFIO) under Corporate Affairs Ministry and the Economic Offences Wing of Gurgaon police -- have recorded the findings almost four months after a criminal case was filed by Reebok India against two of its former employees.

The main reason for this scam were the governance and operations in the company were mismanaged. The bills were inflated and not recorded correctly. So, the probe clearly indicates that it was not a corporate scam in the apparel manufacturing firm but it was non-adherence to the rules and guidelines of business procedures in the firm," sources privy to the probe said. The guidelines under the Companies Act were violated which is suspected to have led to other contraventions like tax evasion. The I-T which has indicated to an alleged Rs 140 crore tax evasion in the case, the sources said, will now work to ensure that the company, later, does not claim any "bad debt". A bad debt is that amount that is owed to a business or individual and has to be written off by the creditor as a loss because the debt cannot be collected because of a host of reasons.

There were no serious borrowings or lending of Reebok India. The probe agencies investigation will make sure that the firm does not qualify to claim bad debt from anywhere in the later course, Probe agencies have also found that some of the officials of the company could have been involved in the inflation of bills and over-valuation of the goods of the firm.

In the much publicized criminal complaint filed at the Gurgaon police's Economic Offence Wing in May, Reebok India had alleged that its former Managing Director Subhinder Singh Prem and Chief Operating Officer Vishnu Bhagat were involved in an Rs 870-crore fraud by indulging in "criminal conspiracy" and "fraudulent" practises over a period of time. Gurgaon police had some days back arrested Subhinder Singh and Vishnu Bhagat along with three others – Sanjay Mishra, Prashant Bhatnagar and Surakshit Bhat.

Subhinder Singh and Vishnu Bhagat were booked for fraud, criminal conspiracy and other charges under IPC for allegedly siphoning off the sportswear company's money by creating ghost distributors across the country and generating forged bills over the last five years. While the I-T department is scrutinising documents related to accounts and imports of the firm, the SFIO is probing the entire governance affairs of the company under Section 235 of the Companies Act. According to sources, the probe agencies also do not rule out the culpability of accounting officials of the firm at this stage for their "deliberate" or "mistaken oversight" in account books which led to the alleged financial irregularities.

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Investigating authorities blamed it on the gross mismanagement in corporate governance and collapse of business planning and ruling of the company. SFIO investigations reveal Reebok India ran a "franchisee referral programme", through which it collected Rs 88.11 crore from 60-odd high net-worth individuals, including former attorney general Soli J Sorabjee, promising interest of 16-20 per cent. The SFIO investigators say these funds were recycled by Reebok India employees as part of effort to boost cash flow. SFIO said there was a lapse in corporate governance practices at Reebok India by the Adidas group.

IV. Corporate Governance Failure at CRB Capital Markets ltd(financial Irregularities & Illegalities)

The case examines:

- How the CRB group was able to defraud the investors and the regulatory authorities with ease. The role of RBI and SBI is also explored.
- It exposes ineffectiveness of regulators, and risk faced by small investors.

The Bhansali scam resulted in a loss of over INR 1200 cr. He launched the finance company CRB Capital Markets, a public limited company and ruled like a financial wizard from 1992 to 1996 by collecting money from the public in the form of fixed deposits, bonds and debentures and money was transferred to the 133 subsidiaries and unlisted companies that never existed. The company offered various services including merchant banking, leasing and hire purchase, bill discounting and corporate funds management, fixed deposit and resources mobilization, mutual funds and asset management, international finance and forex operations.

The group's global outlook and timely foreign collaborations were responsible for its success. Suspicions arose when CRB cap's net-worth grew from INR 2 crores in 1992 to INR430 crores in 1996. In mid 1996, reports regarding frauds being committed by CRB group started to reveal out.

a) *Problem*

- ➢ The company collected money from the public in the form of fixed deposits, bonds and debentures and money was transferred to the 133 subsidiaries and unlisted companies that never existed.
- ➢ Financial irregularities & illegalities were taking place. The company had allegedly used its SBI accounts to siphon off bank funds, claiming it was cashing interest warrants and refund warrants of principal amounts.
- ➢ Rigging share prices through own money, Dummy companies made by Bhansali.
- ➢ The company was not making payments to the fixed deposits.
- ➢ CRB Capital was a defaulting NBFC and as a consequence was liable to be wound up under Section 45MC of the RBI Act. A number of co-operative banks in the State of Gujarat had placed funds aggregating INR 50 crores with CRB Capital and they had received a severe jolt because of the non-payment of those deposits by CRB.
- ➢ Siphoning off of funds from SBI; as the alleged large scale misuse of the 'at par' discounting facility by CRB Capital.
- ➢ CRB Capital, although it had net owned funds of more than INR 50 Lakhs, did not apply for registration till the year 1996 though it was pointed out by the RBI that on 12.04.1993, based on the Shah Committee recommendations on the role of NBFCs a circular was issued to all the NBFCs advising them to get themselves registered with RBI if their net owned funds were more than INR 50 Lakhs.
- ➢ Several illegalities and irregularities came to light. RBI had also received complaints from the Tourism Finance Corporation of India Limited regarding non-payment of deposits. CRB corporation's income more than doubled between 1994-1996.
- ➢ Defrauding the SBI; dividend warrants treated as demand drafts, no overdraft allowed. Bhansali used fake accounts in Chennai, Calcutta and rajasthan to withdraw the dividends from SBI accounts.

b) *Solutions*

The problems were analysed thoroughly & solutions were implemented immediately as the problem was declining investor confidence in banks, poor performance of NBFC's, for creation of smart investors and much more.

The following solutions were implemented:

- ❖ RBI filed a winding up petition claiming that the continuance of the CRB Group was not in interest of the public and depositors. The order prohibited CRB from selling, transferring, mortgaging or dealing in any manner with its assets & from accepting public deposits.
- ❖ Cases had been registered against all the accused under sections 120-B and 420 of the Criminal Procedure Code and the Prevention of Corruption Act.
- ❖ The high court here has set up a three-member committee with a year's term, chaired by retired district judge S K Tandon, with wide powers to ensure termination of the scheme and repayment to unit holders.
- ❖ RBI agreed that the continuance of CRB Capital, a Non-Banking Financial Company, was detrimental to public interest and also detrimental to the interest of depositors of the company. Hence, RBI decided to apply for winding up of CRB Capital by invoking the provisions of Section 45MC (1) (d) of the RBI Act.
- ❖ RBI issued a prohibitory order under Section 45K read with Section 45MB (1) and 45MB (2) of the RBI Act. By virtue of the said order, RBI prohibited CRB Capital from accepting deposits with immediate effect and CRB Capital was also precluded from accepting deposits from any person in any form whether by way of fresh deposits or renewal or otherwise.
- ❖ RBI directed CRB Capital not to sell, transfer, create charge or mortgage or deal in any manner with its property and assets without prior written permission of RBI for a period of six months from the date of the order.

At last, all happened because of:

- ▪ Lack of communication between the banks, RBI and the government officials.
- ▪ Blame game between RBI and SEBI.
- ▪ RBI claimed that it had no power to examine the asset quality.

V. Corporate Governance Failure at Ranbaxy Laboratories

At Ranbaxy, the corporate governance failures manifested in the board's failure to check fraud, absence of the adequate risk management system and unethical practices. The top management overrode the internal system. The board had several independent directors who are enlightened leaders in their own field. It is very unlikely that those who were on the Ranbaxy Board had no exposure to the corporate governance models. According to the media reports, Ranbaxy committed systematic fraud in its worldwide regulatory filings. They also systematically perpetrated fraud on shareholders by exposing their investment to huge reputation and compliance risks by fuzzing data submitted to regulators. They also committed perpetrated fraud on consumers, hospitals, value chain partners and common Indians who took pride that Ranbaxy had emerged as the first Indian multinational in the pharmaceutical sector by selling adulterated drugs. Everyone expected corporate governance of highest order with the illustrious Board and significant foreign and institutional shareholding, however the reality was different.

This failure of the Ranbaxy's corporate governance has exposed the Indian regulators'. First up, it proves beyond doubt that there is no monitoring, by an independent agency, of business practices of wannabe Indian multinationals. The Ranbaxy affair also raises issues of executive conduct. The men, who were at the helm of the company in the days when it was growing rapidly on the back of such fraud, have mostly moved out now. But that does not absolve them. The company has acknowledged that in 2003 and 2005 it was informed of current good manufacturing practice (cGMP) violations by consultants it hired to conduct audits at its Paonta Sahib and Dewas facilities.

The company was fined $500 million. It was considered that the fine it has to pay is actually fairly light sentence for what it has done to the generics business out of India. The rapidly growing industry is now under a cloud. The first consequences of Ranbaxy's actions are already being felt with the FDA issuing an alert banning import of products made at another pharma exporter Wockhardt's plant in Aurangabad. Ranbaxy's is no ordinary misdemeanor. The US department of justice said the company had "pleaded guilty today to felony charges relating to the manufacture of certain adulterated drugs". Felony is a serious criminal charge. By accepting to pay a criminal fine and forfeiture and agreeing to settle civil claims, Ranbaxy may have succeeded in effecting damage control. That does not, however, mitigate the seriousness of its actions.

VI. Aftermath

In 2008, the company was acquired by the Japanese pharmaceutical company Daiichi Sankyo acquired a controlling stake. *In 2014*, Sun Pharma acquired the entire 63.4% share of Ranbaxy and is currently held under the parental company Sun Pharmaceuticals Limited.

VII. Corporate Governance Failure at Sahara

Parties involved

Two groups of Sahara India:

a) *Sahara India Real Estate Corporation and Sahara Housing Investment Corporation*

Sahara's investment program included schemes that were similar to a typical Indian bank's fixed or recurring deposits. The company largely sold such schemes to small investors in towns and rural areas through their network of agents. These financial products allowed investors to deposit small amounts such as 50 rupees per day for returns that were said to be higher than what bank deposits would generate.

OFCD instruments were issued in the name of the two companies but the cheques were sought in the name of Sahara India. The money raise through OFCDs was camouflaged as private placements whereas they were public issues. These debentures can be converted into shares at the will of the debt holder or the investor but the price is decided by the company.

b) *Problem*

The public notice comes after RBI received complaints from individuals that the Sahara group is mobilizing money from the public under the generic name of Sahara Pariwar and Sahara India Pariwar. These two companies are not registered under RBI. Only three Sahara group entities are registered with RBI -- Sahara India Financial Corp. Ltd (SIFCL), Sahara India Corp Investment Ltd (SICIL) and Sahara India Infrastructural Development Ltd. (SIIDL).Of these three entities, SIFCL, a residual non-banking company, has been directed by RBI to phase out acceptance of deposits from the public. SICIL and SIIDL are not authorized to accept deposits from the public.

The order to arrest Subrata Roy and two directors of Sahara was issued for their failure to appear before the apex court in a contempt case arising out of non refund of Rs 24,600 crores to investors by two of the Sahara group companies.

c) *The Year 2012*

The apex court by its August 31, 2012 order had asked Sahara India Real Estate Corp Ltd. (SIRECL) and Sahara Housing Investment Corporation Limited (SHICL) to return, along with 15 percent interest, the investors INR 24,600 crore that two companies had collected through optionally fully convertible debentures (OFCSs) in 2007-08

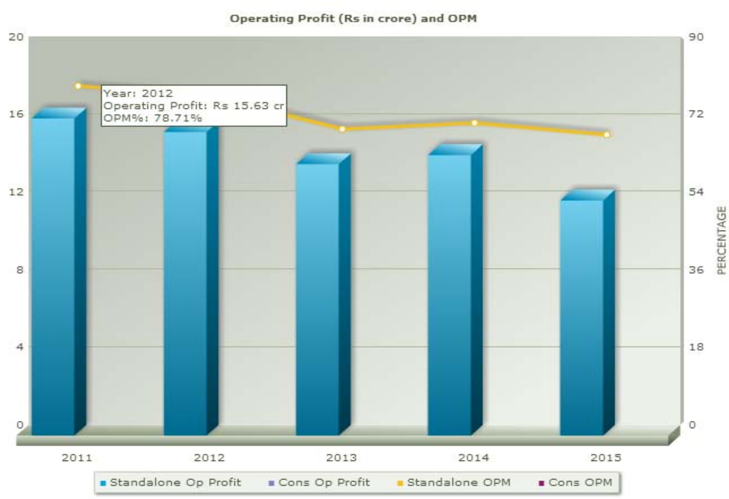
d) 2014

The apex court by its March 26, 2014 order had asked Sahara to deposit INR10, 000crore - INR 5000 crores in cash and INR 5,000 crores in bank guarantee - towards the repayment of the investors money. It had said that this was also a condition for the release of Roy and the other directors from Tihar Jail where they are locked in judicial custody.

e) 2015

Sahara India now claims that it has already repaid around INR 23,000crore directly to the investors and above that it has already submitted INR 12000crore to SEBI. Out of the investors it has repaid it has submitted proof for about 75% and 25% still remains which they say is lying in their Mumbai godowns. But the proof of investors which they have submitted is generally incomplete with some forms only consisting of village name or only mobile number or even only name of the investor. SEBI also required details of bank accounts in the form of financial papers but Sahara contented that bulk of their investors did not have bank accounts in formal financial papers.

Between 2008 and 2012 the RBI auditors have been checking the authenticity of investors under strict norms and only then the next months payments were allowed and they have not found even one fictitious account during these four years Sahara claims to deposit around Rs 18000 crores by the time Subrata Roy is bailed out of jail and has already deposited Rs 12000 crores with SEBI so far out of which SEBI has refunded only Rs 2000 crores to the investors.



(Source: BSE Analytics)

VIII. Recommendations

1. The ultimate power in a company must rest with the shareholders.
2. No shareholder should benefit from special advantages.
3. The shareholders must approve executive compensation. The board of directors must ensure alignment between executive and shareholder interests.
4. The board of directors must have access to all the information it requires to fully discharge its responsibilities.
5. The corporate governance related laws and practices should be strongly implemented and adhered to by all corporate houses.
6. There should be stringent control measures to prevent corporate frauds and an ambit for quick procedure to deal with such cases. The whistle-blowers must be given more autonomy and security.

IX. Conclusion

- As Indian companies compete for globally for access to capital markets, may are finding that the ability to benchmark against world-class organization is essential.
- For a long time, India was a managed, protected economy with the corporate sector operating in the insular fashion.
- But as restrictions have eased, Indian corporations are emerging on the world stage and discovering that the old ways of doing business are no longer sufficient in such a fast paced global environment.

A transparent and timely communication between those who are involved in decision making process must be the first tool that can prevent cases of failure. The link between information and fraud prevention must go beyond the particular mode of corporate governance chosen, organizational structure and control mechanisms applied. People are more important than processes, so one of the main goals is to encourage the diffusion of advanced practices, which lead not only to defend the interests of investors but also to ensure social stability, improving the quality of human capital and promoting authentic values. Financial crises detached from economic crises about we heard last year's can head us on two ways, namely, accounting fraud can be attributed to excessive control or lack of control, external standards provided by the company or by internal regulations. Highlight the close links between fraud and corporate governance is relevant again. These items mentioned are really important, in idea that the regulations remain ineffective if there is not a tandem with organizational culture, supported by strong ethical principles, to point out the priorities, transparency of accounting information and efficiency of exercised control. Removing conflicts of interest is the safest way to ensure the correct functioning of control systems.

As possible ways to avoid future cases of collapse may be the following:

- Separation of powers of the Chairman and CEO. Each has to activate on its own pathway, otherwise we could reach a situation of excessive concentration of power and control capabilities of the supervisory board to be diluted.
- Integrity and missing of conflict of interest between managers, that should not target capital gains from the position they occupy, rather than wage remuneration they deserve.
- The existence of a strict flow of information so that decision-makers, have to receive timely and adequate information to perform their duties.
- Drawing concrete tasks and functions, especially in management teams, where decisions require a sustained effort and a great responsibility.

Finally Although here have been treated just a few of the many cases of corporative governance failure, we attend to believe that we managed to emphasize the main ideas, which are the interpretation and point of view of the authors, and as a solution to eliminate or at least to reduce the differences between the three main types of corporate governance, we would see a set of standards and requirements that include features of all types of governance factors, namely an attempt to globalize the management techniques.

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