

Strategies that Led to Failure -Case Study of Corporate Governance

Dr. Navita Mahajan

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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.

Index terms— corporate governance, principles, failure, scandals, stakeholders.

1 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.

2 II.

3 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

Author: e-mail: nmahajan@amity.edu 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 coexistence 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 governmentowned 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.

43 4 b) The structure of company boards

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

47 5 c) The financial structure

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

51 6 d) The institutional environment

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

57 7 III.

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

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

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

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

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

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

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96 affairs of the company under Section 235 of the Companies Act.

97 Investigating authorities blamed it on the gross mismanagement in corporate governance and collapse of
98 business planning and ruling of the company. SFIO investigations reveal Reebok India ran a "franchisee referral
99 programme", through which it collected Rs 88.11 crore from 60-odd high net-worth individuals, including former
100 attorney general Soli J Sorabjee, promising interest of 16-20 per cent. The SFIO investigators say these funds

101 were recycled by Reebok India employees as part of effort to boost cash flow. SFIO said there was a lapse in
102 corporate governance practices at Reebok India by the Adidas group.

103 8 IV. Corporate Governance Failure at CRB

104 Capital Markets Ltd(financial Irregularities & Illegalities)

105 The case examines:

106 ? How the CRB group was able to defraud the investors and the regulatory authorities with ease. The role of
107 RBI and SBI is also explored.

108 ? It exposes ineffectiveness of regulators, and risk faced by small investors.

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

115 The group's global outlook and timely foreign collaborations were responsible for its success. ? Several
116 illegalities and irregularities came to light. RBI had also received complaints from the Tourism Finance
117 Corporation of India Limited regarding nonpayment of deposits. CRB corporation's income more than doubled
118 between 1994-1996.

119 ? Defrauding the SBI; dividend warrants treated as demand drafts, no overdraft allowed. Bhansali used fake
120 accounts in Chennai, Calcutta and rajasthan to withdraw the dividends from SBI accounts.

121 9 b) Solutions

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

124 The following solutions were implemented: ? RBI filed a winding up petition claiming that the continuance
125 of the CRB Group was not in interest of the public and depositors. The order prohibited CRB from selling,
126 transferring, mortgaging or dealing in any manner with its assets & from accepting public deposits. ? Cases had
127 been registered against all the accused under sections 120-B and 420 of the Criminal Procedure Code and the
128 Prevention of Corruption Act.

129 ? The high court here has set up a three-member committee with a year's term, chaired by retired district
130 judge S K Tandon, with wide powers to ensure termination of the scheme and repayment to unit holders.

131 ? RBI agreed that the continuance of CRB Capital, a Non-Banking Financial Company, was detrimental to
132 public interest and also detrimental to the interest of depositors of the company. Hence, RBI decided to apply
133 for winding up of CRB Capital by invoking the provisions of Section 45MC (1) (d) of the RBI Act.

134 ? RBI issued a prohibitory order under Section 45K read with Section 45MB (1) and 45MB (2) of the RBI
135 Act. By virtue of the said order, RBI prohibited CRB Capital from accepting deposits with immediate effect and
136 CRB Capital was also precluded from accepting deposits from any person in any form whether by way of fresh
137 deposits or renewal or otherwise.

138 ? RBI directed CRB Capital not to sell, transfer, create charge or mortgage or deal in any manner with its
139 property and assets without prior written permission of RBI for a period of six months from the date of the
140 order.

141 At last, all happened because of:

142 ? Lack of communication between the banks, RBI and the government officials.

143 ? Blame game between RBI and SEBI.

144 ? RBI claimed that it had no power to examine the asset quality.

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

156 This failure of the Ranbaxy's corporate governance has exposed the Indian regulators'. First up, it proves
157 beyond doubt that there is no monitoring, by an independent agency, of business practices of wannabe Indian
158 multinationals. The Ranbaxy affair also raises issues of executive conduct. The men, who were at the helm of the
159 company in the days when it was growing rapidly on the back of such fraud, have mostly moved out now. But
160 that does not absolve them. The company has acknowledged that in 2003 and 2005 it was informed of current

161 good manufacturing practice (cGMP) violations by consultants it hired to conduct audits at its Paonta Sahib
162 and Dewas facilities.

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

171 10 VI.

172 11 Aftermath

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

176 12 VII. Corporate Governance Failure at Sahara

177 Parties involved Two groups of Sahara India:

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

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

187 13 b) Problem

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

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

198 14 c) The Year 2012

199 The apex court by its August 31, 2012 order had asked Sahara India Real Estate Corp Ltd. (SIRECL) and
200 Sahara Housing Investment Corporation Limited (SHICL) to return, along with 15 percent interest, the investors
201 INR 24,600 crore that two companies had collected through optionally fully convertible debentures (OFCSs) in
202 2007-08

203 15 d) 2014

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

208 16 e) 2015

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

215 Between 2008 and 2012 the RBI auditors have been checking the authenticity of investors under strict norms
216 and only then the next months payments were allowed and they have not found even one fictitious account during
217 these four years Sahara claims to deposit around Rs 18000 crores by the time Subrata Roy is bailed out of jail
218 and has already deposited Rs 12000 crores with SEBI so far out of which SEBI has refunded only Rs 2000 crores
219 to the investors. practices should be strongly implemented and adhered to by all corporate houses. 6. There
220 should be stringent control measures to prevent corporate frauds and an ambit for quick procedure to deal with
221 such cases. The whistleblowers must be given more autonomy and security.

222 IX.

223 17 Conclusion

224 ? As Indian companies compete for globally for access to capital markets, may are finding that the ability to
225 benchmark against world-class organization is essential.

226 ? For a long time, India was a managed, protected economy with the corporate sector operating in the insular
227 fashion.

228 ? But as restrictions have eased, Indian corporations are emerging on the world stage and discovering that
229 the old ways of doing business are no longer sufficient in such a fast paced global environment.

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

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

242 ? Separation of powers of the Chairman and CEO.

243 Each has to activate on its own pathway, otherwise we could reach a situation of excessive concentration of
244 power and control capabilities of the supervisory board to be diluted.

245 ? Integrity and missing of conflict of interest between managers, that should not target capital gains from the
246 position they occupy, rather than wage remuneration they deserve.

247 ? The existence of a strict flow of information so that decision-makers, have to receive timely and adequate
248 information to perform their duties.

249 ? Drawing concrete tasks and functions, especially in management teams, where decisions require a sustained
250 effort and a great responsibility. Finally Although here have been treated just a few of the many cases of
251 corporative governance failure, we attend to believe that we managed to emphasize the main ideas, which are the
252 interpretation and point of view of the authors, and as a solution to eliminate or at least to reduce the differences
253 between the three main types of corporate governance, we would see a set of standards and requirements that
254 include features of all types of governance factors, namely an attempt to globalize the management techniques. ¹



Figure 1: