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# "CULTURE OF THE FAST BUCK": A CASE STUDY OF CORPORATE FRAUD IN INDIA


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## ABSTRACT

*In this era of liberalization, the so called "culture of the fast buck" dominates the business world. Consequently fraud has become a common phenomenon that has affected almost all continents and all sectors of the economy. The offenders have not only swindled millions and billions of money but shook the very base of business, finance and accounts.*

*The objective of this paper is to analyse the situation in India in this light. The scams in India bear testimony to wrongful behaviour where actions have been taken against public interest. All the scams that have occurred in the post liberalization period, starting from the Harshad Mehta Scam(1992), UTI Scam (2001) to 2G Spectrum Scam(2008) and Satyam Scandal(2009,) involved deliberated actions from society's leadership, employees or third parties to obtain quick material gain and unjust advantages. The fraudulent activities have questioned the integrity of financial reports, contributed to substantial economic losses and eroded investor's confidence in the reliability of financial statements. To combat such white collar crimes have emerged tools like corporate governance, forensic accounting and whistleblowing policy. The solutions are not new but have been reinvigorated with the current flurry of corporate frauds. The paper tries to enquire in the scope and prospects of such new age solutions in India.*

*Findings reveal that in all the instances of corporate frauds, ethical conflicts played against public interest and with public money. The enormity of the scams has affected the organizations involved financially, operably and psychologically with devastating ripple effects. The scams have induced a crisis in confidence in financial accounting practice and effectiveness of corporate governance. Policy tools like forensic accounting and whistle blowing are in very nascent stage and needs to be more organized and made mandatory for all accounting firms and business organizations to revive the confidence of the people at large.*

**KEYWORDS:** *Corporate Frauds, Corporate Governance, Forensic Accounting, Scams, Whistle Blowing Policy.*

## 1. INTRODUCTION:

In this era of liberalization with the economy under business cycles and changing accounting rules, fraudulent and unethical activities have become common. The culture of the fast buck is dominating the business environment.The urge for making quick money relegates ethic to the back seat. Even when the companies adhere to certain fundamental principles related to ethics, individuals take recourse to wrongful activities either for self- interest, or to shield or justify errors already committed or are subjected totremendous pressure -horizontally or vertically, to act against the fundamental principles of the Company. In all most all the scams that have occurred- UTI, Satyam or 2G Spectrum, accounting information and financial statements were false or manipulated but the logic remains the same.Individuals emphasized on short term gains and small unethical issues were initially ignored in the organizations concerned. In all the cases actions were taken without considering the consequences it will have on others-individuals and

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stakeholders, a situation that goes completely against the true spirit of business and finance, where professionals are supposed to act solely in public interest.

The fraudulent activities have questioned the integrity of financial reports, contributed to substantial economic losses and eroded investor's confidence in the reliability of financial statements. To combat such white collar crimes have emerged tools like corporate governance, forensic accounting and whistleblowing policy. The solutions are not new but have been reinvigorated with the current flurry of corporate frauds.

## 2. LITERATURE REVIEW

Fraud is deceit, impersonation with intent to deceive, criminal deception done with the intention of gaining an advantage. Fraud is perceived as a special kind of hedge against systematic risk but at the cost of moral risk (Cloninger, 1982). Goldstrawet. al. (2005) has shown that greed, gambling, financial strain, either personal or business, feasibility of business, and influence of others are the major factorsstimulating illegal behaviour among employees. Fraud is among the most serious, costly, stigmatizing, and punitive forms of liability imposed on individuals in modern corporations and financial markets(Buell, 2011; Green, 2007). Frauds are comparatively common in more competitive industries with lower product market sensitivity and tend to occur in cyclical manner (Gigler, 1994; Wang and Winton, 2012). Corporate frauds are defined as firm's or its manager's misconduct behaviour, which causes material value loss to shareholders or stakeholders (e.g., creditors, customers and suppliers) and which may trigger regulatory and/or legal enforcements (Yu, 2013). Another interesting finding is that corporate frauds peak at the end of a boom period when investors do not have urge to monitor the business with positive public information and so propensity for crime is the highest (Povel et. al.,2007; Wang et. al.,2010; Mongie, 2009).

To avoid fraud and theft and restore public confidence have emerged tools like corporate governance**,** forensic accounting and whistle-blowing. Financial information represents a way to communicate with stakeholders, but the real relationship with them depends on corporate governance model (Tiscini and Donato, 2006). Studies by Agrawal and Chadha (2005), Kedia and Philippone (2009) show that while distorted incentives encourage managers' fraudulent behaviours, the monitoringsystem, in the form of corporate governance, serves as a deterrent.It acts as a set of mechanisms through which outside investors (shareholders) protect themselves from inside investors, managers (La Porta, Silanes and Shliefer 2000; 2002). In the event of difference in perspective and risk preferences between managers and shareholders, effective corporate governance can implement these devices which includes the composition ofthe board of directors, increase number of shareholders, maximize the inside ownership and by providingdifferent financial policies and compensation packages(Farinha ,2003).

Forensic accounting has been pivotal in identification and prevention of corporate frauds all over the world. The term was coined by Maurice E. Peloubet in 1946 but was put into formal use not before 1980s(Rasey 2009).It is defined as the integration of accounting, auditing, and investigative skills for the purpose of resolving financial issues in a manner that meets standards required by courts of law (Hopwood, Leiner and Young ,2008 ;Kasum, 2009).In literature the origin of forensic accounting has been ascribed to Kautilya, the first economist to openlyrecognize the need for the forensic accountant(Joshi, 2003). Forensic scientists are referred to as examiners and interpreters of evidence and facts in legal cases that also offers expert opinions regarding their findings in court of law(Crumbley, 2003). Investigation of corporate frauds, litigation services, business valuation and computer forensic are the areas identified by Coenen (2005). If well applied forensic accounting can serve as an anecdote in economic and financial crimes ( Apostolou,.Hassell, and Webber, 2010; Adegbie and Fakile ,2012;Modugu and Anyaduba ,2013; Okoye and Gbegi ,2013).

Another tool for early detection of fraud is 'Whistleblowing'. It is an act of disclosure of information about activities that are against public interest, by people within or outside the organization, that are not otherwise accessible to public (Ahern and McDonald, 2002;Bolsin et al.,2005; Lee, 2005). Literature claims that whistleblowing policies are effective in curbing fraudulent practices (Ewing 1983, Miceli & Near 1985;Bamett 1993). Whistle blowers are found to be more knowledge able about the internal whistleblowing channels and presence of formal disclosure policies and procedures lead to more such actions(Miceli& Near 1985;Bamett, Cochran, & Taylor, 1993). But again, employees who familiarize with individual or corporate misconducts do not publicize or reveal their observations to anybody in anticipation of major threats (Brewer, 2005).

## 3. RESEARCH OBJECTIVE

In the post liberalization era fraud has become common and has affected almost all continents and all sectors of the economy. India is no exception to it. The scandals resulted in loss of huge amount of money and what's worse, public trust. Again, to combat the increasing incidence of financial frauds tools like corporate governance, forensic accounting and whistleblowing policy have been used world-wide. The solutions are not new but have been reinvigorated with the current flurry of corporate frauds.

The main objectives of this study are: (1) to review the incidence of corporate frauds in India (2) to analyse the policy of whistle blowingrelating it to the concept of ethical dilemma(3)to study the progress and prospect of new age solutions like corporate governance and forensic accounting in a developing country like India.

## 4. DATABASE AND METHODOLOGY

The study has been done in three parts. In the first part we study the major incidences of corporate fraudsin India in the post liberalization period. Here the role of or for that matter lack of ethics behind such fraudulent activities have been addressed. In the second part we discuss in detail the concept of whistleblowing in relation to ethics and its implementation in India. In the last part we try to enquire in the scope and prospects of new age solutions like corporate governance, forensic accounting and whistle blowing in India. The study is descriptive in nature and is based onsecondary data, reports and web resources.

## 5.1 CORPORATE FRAUDS IN INDIA

There has been a continued persistence of corporate frauds all over the world andfraud risk is assumed to be present in the business structures of large- and medium-sizedorganisations including banks. India has witnessed hundreds of scams since independence. According to a survey of fraud in India in 2010, most of the corruption has been for obtaining routine administrative approvals or are attempts to win / retain business. The fraudulent cases in the corporate sectors involved actions like manipulation, falsification, alteration of accounting records, misrepresentation or intentional omission of amounts, misapplication of accounting principles, intentionally false, misleading or omitted disclosures. Some ofthe scams worth mentioning are HaridasMundhra (1957), Nagarwala (1971), Antulayand cement (1982), Bofors (1989), Harshad Mehta(1992), palmolein oil imports in Kerala (1992), Telgi(1995), SNC Lavalin in Kerala (1995), Sukhram andtelecom (1996), fodder in Bihar (1996), Jain hawala(1997), Ketan Parekh (2001), the Barak missile(2001), Kargil coffins (2002), the Taj corridor(2003), the PDS scam in Arunachal (2004), oil for food (2005), Scorpene submarine deal (2006),stamppapers (2005), cash for votes (2008), Satyam(2008), MadhuKoda and mining (2009), 2-G (2010),Commonwealth Games (2010), Adarsh HousingSociety (2010), housing loans by banking andfinancial institutions (2010), Belekiri port inKarnataka (2010), foodgrains in Uttar Pradesh (2010), Bellary mines (2011), Saradha Group Scam (2013) and Sahara India Scandal (2014).

When we talk about the top corruption scams in Indiain the post liberalization era, the Satyam fraud occupies a high position often named as Indian Enron. Again considering the inflationary situation, the 2G Spectrum scam is worth mentioning, that involved the process of allocating unified access service licences at throw-away prices. Liberalization in the nineties led to the liberalization of the UTIand the US-64 scheme was converted from debt based fund into an equity based fund. The scheme went out of the purview of SEBI thus conferring arbitrary powers on the chairman to decide upon its investments that led to the worst capital market scams that played with money and lives of many people. Although not corruption scams in the strict sense of the term, the Harshad Mehta and the Ketan Parekh scam have affected many people.Among the various Ponzi schemes affecting the Indian economy, one that ruined the poor and the middle income people is the Sharadha Chit Fund scam. Here the company took advantage of unsuspecting investors looking for alternate banking options and collected money from investors by issuing redeemable bonds and secured debentures and promising incredulously high profits from reasonable investments. The syndicate comprising of more than 200 companies engaged in money laundering and ultimately collapsed in 2013.In 2014 another shockwave rose in connection with black money laundering and misuse of political connections against the Sahara Group of Companies that continuously defied SEBI regulations.The top instances of frauds or scams in India in Table 1.below.

**Table 1: List of Major Corporate Scams in India**

| Frauds in India | Year | Size | Individuals Involved | Summary of the Scam |
|---|---|---|---|---|
| Sharadha Group Scam | 2014 | Rs.24600 Crores | SudiptoSen, Chairman and Managing Director and Debjani Mukherjee, Executive Director | Operated various collective investment schemes (CIS) involving tourism packages, forward travel and hotel booking , real estate, infrastructure finance, and motorcycle manufacturing. Investors were rarely informed about the true nature of their investments. Instead, many were told they would get high returns after a fixed period. With other investors, the investment was fraudulently sold in the form of a *chit fund*. |
| Sahara India Scam | 2014 | Rs. 24000 Crores | Subrata Ray, Chairman and Founder | Sahara India Real Estate Corp (SIREC) and Sahara Housing Investment Corp (SHIC) raised several thousand crores through optionally fully convertible debentures (OCFDs) that SEBI deemed illegal. |
| Satyam Scam | 2009 | Rs.14000 Crores | Ramalinga Raju & his family, CFO & other top level management, Auditors & Board of Directors | Falsified revenues, margins and cash balance, operating profit artificially boosted from 61 crores to 649 crores |
| 2G Spectrum | 2009 | Rs.1760 Billion | A Raja, MK Kanimozhi, NiraRadia and many Telecom Companies | Irregularities in awarding spectrum licenses. License issued on first cum first serve basis instead of auction. Advancing of cut-off date which is illegal. |
| UTI Scam | 2000 | Rs. 32 Crores | Former UTI chairman P S Subramanyam and two executive directors -- M MKapur and S K Basu -- and a stockbroker Rakesh G | UTI had purchased 40,000 shares of Cyberspace for about Rs. 3.33 crore (Rs. 33.3 million) from Rakesh Mehta when there were no buyers for the scrip. The market price was around Rs 830. |
| Harshad Mehta Scam | 1992 | Rs. 4000 Crores | Harshad Mehta and his associates | Taking advantages of the loopholes in the banking system, triggered a securities scam diverting funds from the banks to stockbrokers. |
| Ketan Parekh Scam | 1999-2001 | Rs 1000 Crores | Ketan Parekh and his associates | Targetted smaller exchanges like the Allahabad Stock Exchange and the Calcutta Stock Exchange, and bought shares in fictitious names and managed to get Rs 1,000 crore from the Madhavpura Mercantile Co-operative Bank |

**Source:** Authors compilation



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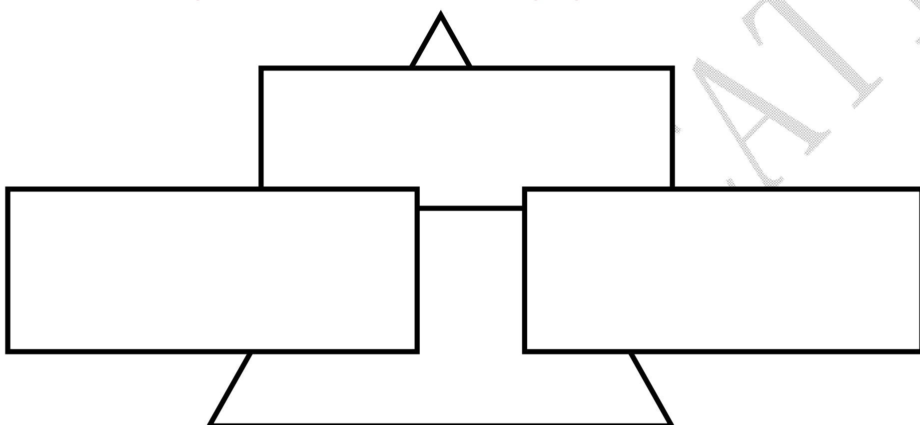
With liberalization and opening up of the economy these scams have gained the power to affect the global economy. So with corporate frauds, insurance frauds, political frauds, fake currency and stamp paper and fodder scams, millions and billions of money have been wasted with ripple effects in all sectors of the economy. Corporate frauds have risen from 37% in 2010 to 45% in 2014.

The scams are not to be treated as isolated events with no real repercussions but as those having deep ethical considerations and significant implications in our lives. It directly or indirectly deals with ethics of the individuals involved or the organizations that crossed the ethical boundaries and have far reaching consequences. So before discussing about the ways to curb such misconduct in business we just briefly review the role of ethics and morality as the missing link between the fraudulent act and the new age solutions.

In all the cases of fraud enlisted there has been persistent and pervasive manipulation of public funds and the scale of these crimes are alarmingindeed. It is known that when a scam takes place three components come together –*pressure*, *opportunity* and *justification* that constitute the "fraud triangle" (Bozkurt 2003).

**The Fraud Triangle: A framework for detecting high risk fraud situations**



Pressure factors can be grouped into three categories- pressures with financial content, pressures stemming from bad habits and pressures related to job. Among all these factors, pressures arising out of financial discontent leads to the maximum incidence of crimes. The desire to live well and make quick money instigates frauds. Opportunity factors involve top management and owners of the business in particular and making the most of the opportunity to commit frauds is evident in all the scams listed above. The third component of the fraud triangle deals with the development of defense mechanism to justify the action of crime. Individuals committing frauds try to justify themselves by giving excuses like they had just borrowed the money with the noble intention to pay it back, the action is not meant to cause distress to anybody and that they did not know that it was at all a crime. But behind all these factors constituting the fraud triangle is that one attribute that is operative is the lack of ethics and moral judgement.

There is no justification for succumbing to any type of pressures or taking opportunities to commit financial crime that can cause distress to so many individuals. Things would have been different had there been a strong ethical background of the individuals concerned or the organization involved had strict moral codes to abide by. All the above incidences of frauds bear testimony to the lack of ethics where the fraudsters did not care about the after effects of their action on people or business or the economy at large. In all the cases it is greed which has gained prominence, the frauds being committed by middle aged top ranking male individuals with poor ethics and value judgement.

## 5.2 WHISTLE BLOWING AND ETHICAL DILEMMA

Whistleblowing is a channel for unveiling information about illegal and unethical activities. Whistle-blowers may make their allegations internally (for example, to other people within the accused organization) or externally (to regulators, law enforcement agencies, to the media or to groups concernedwith the issues). Any organization with a robust whistleblower system can rectify scandals earlier and reduce corruption. It has the power to expose high profit scandals to financial crimes.

This act of safeguard however has its costs. In a number of cases the whistle blowers have lost their jobs, peace of mind andlives. So even if an individual within or outside the system comes to know of any irregularities in business, he suffers from ethical dilemma about whether to report it or not, in public or in anonymity, be loyal to organization, employees and co-workers or be responsible to public, value professional judgement or organizational authority. Potential conflicts exist in the form of trade- off between professional ethics and protectors of public interest versus risk of losing job and even life or accused of being disloyal. So ethical dilemma compounded with ambiguity regarding the consequences of whistleblowing often prevents corruption being reported and remains a shared secret among co-workers.

Employee loyalty and whistleblowing may apparently appear to be antagonistic (dilemma) but at the end both restore the organization and the employee morality. As such education in ethics and human resource development can increase the intensity of whistleblowing and standing up against corruption. Proper ethical leadership and leader member exchange can affect whistleblowing without diluting its impact by the moral intensity of the issue.

In India, whistle blowing is still in its nascent stage. Policies to receive information about violation of code of conduct and ethics in anonymity or Ethics Cell exists in some organizations like Wipro, Tata Motors, Steel Authority of India Limited, Reliance Industries, Tata Consultancy Services and the like. However in many cases of corruption the consequences faced by whistle-blowers are frightening indeed. A list of such cases is provided in Appendix 1 to this paper. What is needed is a proper full- fledged Whistle Blowing Act in India to protect the whistle-blowers and provide them the environment to raise their voice against corruption and save the interest of the stakeholders.Only a robust Whistleblowing Policycan induce employees to report illegal and risky activities directly to the highest authority.

### 5.3 FRAUD AND CORPORATE GOVERNANCE

Liberalization of the economy and free flow of capital has made corporate governance absolutely essential due to the wide spread of shareholders, changing ownership structure, greater expectation of the society of the corporate sector, hostile take overs, huge increase in top management compensation. Itis an important tool that deals with ethics, values, morals, rules, regulations and management practices for the prevention of fraud and ensuring of market credibility and confidence. It operates on the three principles of transparency, accountability and independence.

A common aspect characterising the main scandals enlisted earlier is the relevance of corporate reporting failure, as shown by the willingness of corporate managers to inflate financial results, either by overstating revenues or by understating costs, or to divert company funds to private uses. The stakeholders' rights have been infringed and investments lost thereby thwarting investors' confidence suggesting deficiencies in corporate governance.

The Confederation of Indian Industries in 1998 first came up with a voluntary code called 'Desirable Corporate Governance". Thereafter SEBI (2000) had set up a committee under Shri Kumar Mangalam Birla, member SEBI Board, to promote and raise the standards of good corporate governance. The report submitted by the committee is the first formal and comprehensive attempt to evolve a "Code of Corporate Governance" in the context of prevailing conditions of governance in Indian companies, as well as the state of capital markets. The recommendations classified as mandatory and non-mandatory were implemented through Clause 49 of the Listing Agreements, in a phased manner by SEBI. Incidentally whistleblower policy has been included as mandatory provision under the latest amendments. The financial scams in India led to the reappraisal of corporate governance rules now and again and introduced series of voluntary reforms.After Satyam scam, the Companies Act 1956 has also been reviewed and redrafted by the Ministry of Corporate Affairs and presented as Companies Bill in 2012 incorporating further recommendations for ensuring fair and free business. Corporate governance rules in India are still evolving and needs to be at par with the global governance rules but at the same time tackle country specific situations.

### 5.4 CORPORATE FRAUDS AND FORENSIC ACCOUNTING

Most of the frauds detected in the past have been by chance and by the time the red flag comes out there has been an escalation in the loss amount. So organizations now stress on conducting a proactive research and encourage initial identification of symptoms. Forensic accounting is a very important tool to detect, investigate and prevent frauds in its nascent stage. It is used for fraud detection where employees commit fraud, for criminal investigations, in cases related to professional negligence, for arbitration services and for settlement of insurance claims and other disputes. It involves the integration of accounting, auditing and investigating tools which focus on detecting or preventing accounting fraud. It gathers and presents financial information in a form that will be accepted by the court as evidences against the perpetrators of economic crime. It was introduced in India due the rapid increase in white-collar crimes and lack of sufficient enforcement agencies for uncovering frauds.

Forensic accounting was developed in USA in 1995 and has been in high demand in the developed countries. However in India it has been introduced as an extension of investigative auditing only recently (Ghosh, 2010). In India the complex and traditional judicial systems, political compulsions and high profile influences of corporates and bureaucrats makes the task of unveiling crimes difficult and time consuming. Liberalization of the economy has aggravated the task of fraud detection by forensic accountants due to the problem of inter-jurisdiction. So what is required is the mandatory use of forensic accountingin all the sectors of the economy-law firms, banks, insurance companies especially in the public sector companies and large scale companies, where corruption is rampant. More and more forensic accountants should be involved, bureaucratic red- tapism should be removed, special laws should be enforced for prosecution of the fraudsters irrespective of their domicile to curb the increase in white-collar crimes. Forensic accounting is an expensive tool, requires expertise and proper guidelines for practice, all of which makes it difficult to be initiated on a large scale in a country like India. However small steps are being taken in this direction by regulatory bodies like SEBI which according to The Narayana Murthy Committee on Corporate Governance, has decided to create a forensic accounting cell to improve the quality of the financial information disclosed and to assist in detection of financial irregularities so as to serve as an effective early warning mechanism. RBI has also instructed banks to include forensic auditing practices.

India forensic centre of studies was established in 2005 that provides certifications and specializations such as CFAP. Although few firms have also started to provide forensic services, the area is mainly dominated by Deloitte, KPMG, PWC and Ernst and Young. Government of India also has established agencies SFIO (Serious Fraud Investigation Office) under the Ministry of Corporate Affairs, which is also a landmark development for forensic accountants.

## 6. CONCLUSION

Scandals and scams have wasted resources to the amount over eighty-three crore rupees since 1992.The scams have affected not only the parent organization but the nation as a whole.The recent bout of corporate frauds in India clearly points to the lack of ethics and values in the society and conflict of interests in the parties involved in business. If one has a clear understanding of what is wrong and what is right, which actions can have detrimental effects on the population at large with serious repercussions, objectives would have been balanced and outcomes would have been favourable.Apart from intellectual ability and academic excellence, moral integrity of the individuals should be stressed upon in the growing years. Development of an ethical climate, code of conduct and less bureaucratic structures in the organization can restore the value system and restrict financial crime. Mandatory use of corporate governance and forensic accounting and enactment of Whistle Blowing Act in some firms in India are small but necessary steps in this direction. The study can gain a broader scope with empirical verification of the issues involved.

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## Appendix 1: Some Whistle- Blower Cases in India

| Name of whistle Blower | Designation | Murdered By | Date /Year of Murder | Case Summary | State |
|---|---|---|---|---|---|
| Shanmughan Manjunath | Marketing Manager, IOCL | Oil Mafia | 2005 | Check Petrol Adulteration | Uttar Pradesh |
| Narender Kumar | IPS, Morena | Mining mafia | March, 2012 | Corruption Mining | Madhya Pradesh |
| Sanjiv Bhatt | IPS, Gujarat | Politicians | November, 2013 | Alleged Role of narendraModi in Gujarat Riots | Gujarat |
| J.N.Jayashree | Housewife | - | - | Government Officials of taking bribes and kick-backs | Karnataka |
| Lalit Mehta | Indian RTI, activist (Vikas Sahyog Kendra), | - | 14 May, | Exposed Scams in NREGA | Jharkhand |

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|---|---|---|---|---|---|
| | Palamau | | | | |
| Shashidhar Mishra | Indian RTI, activist, Phulwaria Village (By profession, street vendor) | Unknown Assailants | 14 February, 2012 | Exposed Corruption in Panchayat and Block Levels | Bihar |
| AvijitMisra | Indian Army Colonel from Pandapara, Kalibari, Jalpaiguri, West Bengal | Unknown Assailants | April 2012 | | West Bengal |
| Vijay Pandhare | Chief Engineer of the Water Resources Department and a member of the state level technical advisory committee | - | - | Reported Irregularities and Cost Inflation in Irrigation Projects | |
| Rinku Singh Rahi | Bureaucrat Pro vincial Civil services (PCS) | Local gangsters | 26th march, 2009 | Exposed Corruption in Sponsored Welfare Schemes | Uttar Pradesh |
| Satish Shetty | Indian social activist | Unknown assailants | 13th January, 2010 | Exposed Land Scams | Maharashtra |

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