P: ISSN NO.: 2321-290X RNI : UPBIL/2013/55327 Shrinkhla Ek Shodhparak Vaicharik Patrika
E: ISSN NO.: 2349-980X Vol-III * Issue-I* September -2015

Role of Directors and Major Corporate Scandals

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Abstract

Just as it is impossible to know when a swimming fish will drink water, so it is impossible to find out when a corporate steward is stealing money" (from kautilyas arthshastra 330 B.C.)

As every coin has two sides, similarly, liberalization and globalization, on one side opens the door for employment and better economy but on the other side it gives rise to malpractices and misconducts. Starting from Harshad Mehta scam till Sahara scam and many more, scandals are increasing day by day all over the world resulting into deep sense of dissatisfaction among shareholders and stakeholders raising questions regarding competency of boards and thereby bringing the role of directors under scrutiny.

Keywords: Directors, Corporate Scandals.

Introduction

Manifold increase in number of companies from 30,000 approx. in 1956 to 1,100,000 by 2013 puts the pressure on the government as well as on the companies to create sound corporate governance system so that the investors don't hesitate in investing their money in India.

As India's economy has become one of the fastest growing major economy and since private sector plays major role in India's economy so it is the duty of directors to create fraud free environment by performing their duties and responsibilities sincerely.

The purpose of this paper is to show how these directors who are said to be the protector of the company becomes the destroyer of the company and the common causes lying behind these scandals.

Major Corporate Scandals

Here is a list of major corporate scams starting from Harshad till today.

1. HARSHAD MEHTA SCAM (1991-92)
2. KETAN PAREEKH SCAM (2000-2001)
3. ENRON (2001)
4. SATYAM SCAM (2009)
5. OLYMPUS SCAM (2010)
6. 2G SCAM (2010)
7. SPEAK ASIA SCAM (2011)
8. INDIAN COAL MINING SCAM (2012)
9. REEBOK SACM (2012)
10. RANBAXY SCAM (2013)
11. SAHARA SCAM (2013)
12. SRADHA SCAM (2013)

After analysing the facts of all these scandals here are some common factors which are lying behind every scandal:

No Division of Power

Corporate decisions tend to come from the single views of specific individuals without the appropriate counterbalances.of the same person plays the role chairman and CEO then that person will either be "overpowered" or "overburdedned"

Failure of Board of Directors

When the democrats choose not to be democratic, democracy fails to be democratic. (Ernest AgyemangYeboah)

When directors themselves decides to get involved in malpractices & misconducts then how one can think for the success of the company. Board of directors are mind and soul of an organization. They are supposed to maintain ethical, honest culture within the organization. they are the highest decision making body of an organization but when they themselves remain quiet or become ignorant or get involved in misconducts, then how the company will flourish.As in Ranbaxy scam**,** the board of directors remained quiet even, when Dinseh Thakur, the whistleblower, showed them the presentation of the short cut methods of testing the drugs in their laboratories. Similarly directors in Speak Asia and Saradha scam invovlved in Ponzi schemes.

Passivity of Investors

Investors do not correctly exercise their role as active shareholders, and end up wrongly rewarding firms with unsustainable practices by inflating their stock prices.

Failure of Auditors

Reputational intermediaries such as auditors, stock analysts, credit rating agencies, attorneys, investment banks, and consultants who pledge their reputational capital to vouch for information that investors cannot verify fail their duties.In Satyam, Reebok, Olympus, Enron, auditors failed to perform their duties.

Weak Regulatory Framework

Poor or nonexistent regulation allows the occurrence of misconducts and malpractices.

Overexpansion of the Business

Excessive growth of the company in the years immediately preceding the governance problems, especially via acquisitions, contribute to the scandal

Biased Strategic Decisions

Unintentionally bad top level strategic decisions are made due to cognitive biases such as overconfidence, groupthink, information cascades, etc.

Inflated Financial Statement

The company intentionally publishes doctored financial statements, often inflating profits or hiding its debts as in Satyam, Enron, Reebok.

Weak Internal Controls

The main components of a sound internal control system are missing, such as an adequate control environment, effective risk management and control activities.

Inadequate Compensation System

A compensation system too aggressive and too connected to short-term goals substantially contributes to governance problems.

The Illusion of Success of the Business

People inside and outside the organization come to believe that the company is an absolute success, ignoring contrary evidence and generation a feeling of invincibility.

An internal atmosphere of greed and arrogance- "*need is the mother of invention but greed is the mother of corruption.*" directors missed the bus in understanding the difference between greed and need. Different people has different type of greed like in harshad mehta scam**,** he had a greed to travel in luxurious new branded cars, In satyam scam, ramalinga raju had a greed to increase the firm ***, in*** *2G scam****,*** A.raja had a greed to earn more money, in reebok scam, subhinder singhprem and Vishnu bhagat had a greed to earn more incentives from the company,in saradha scam, sudiptosen had a greed to lead extravagant life, in speak asia scam**,** Ram sumiran Pal had a greed to construct a luxury hotel**.** a very good saying by a German philosopher "***wealth is like sea water; the more we drink, the thirstier we become (Arthur Schopenhaver) (1788-1860.)***

The Lack of the Right Ethical Tone at the Top

"Corporate executives and business owners need to realize that there can be no compromise when it comes to ethics, and there are no easy shortcuts to success. Ethics need to be carefully sown into the fabric of their companies". (VIVEK WADHWA). "Ethics is knowing the difference between what you have a right to do and what is right to do" (Potter Stewart)

Man is a social animal but ethics makes a man a human being.

"**The greatest poverty that can afflict the human spirit is the loss of a generous heart. You will know that success has slipped away when your passion for helping others grows cold".(Bill Lane Doulos)**

CG Seen as a Marketing Tool

"Organisations need to practice qualitative corporate governance rather than quantitative governance thereby ensuring it is properly run."– and "You cannot legislate good behaviour."– Mervyn King (Chairman: King Report).

The principles of CG are (i) integrity and fairness (ii) transparency and disclosures (iii) accountability and responsibility. These principles seems to be ornamental when we look at these scandals like:

Harshad Mehta, Ketan Pareekh Scam

Total lack of transparency in the stock market. Satyam (fake assets reported in the books), Enron (loans and debts converted into income), Reebok (fake bills inserted in book) 2G scam no auction process followed

Indian Coal Mining

Coal blocks allocated in non transparent manner by screening committee.

Ranbaxy

IDs failed tocheck fraud.

Sahara, Olympus

Lack of IDs in the board.

Conflict of Interest

It is the duty of directors to avoid situation in which their own personal interest clashes with the interest of the company. **Greed is the main element of COI & COI is the main element of corruption.** and If we look from harshad mehta scam till sahara scam, every director has given importance to their own desires irrespective of the concern towards the society or shareholders.

Violation of CSR

"Businesses cannot be successful when the society around them fails." 2G scam, Indian coal mining scam shows negligent attitude of directors towards environment. Ranbaxy, Sahara, Speak asia, Saradha shows negligent behavior of directors towards society.

Conclusion

These scandals shows two things- first, non performance of duties by these directors sincerely and secondly it shows that somewhere there is some lacuna either in govt. policies or in laws or in implementation of these laws due to which these scandals recur again and again.

For the frauds involving Ponzi schemes and chit funds it could be said that the disregard towards the society will hamper the national economy. In case of *Ram NarainPoply v. Central Bureau of Investigation, 2003 CRI.L.J.4801 (Supreme Court)* it was held that the cause of the community deserves better treatment at the hands of the court in the discharge of its judicial functions. The community of the State is not a persona non grata whose cause may be treated with disdain. The entire community is aggrieved if economic offenders who ruin the economy of the State are not brought to book. A murder may be committed in the heat of moment upon passions being aroused. An economic offence is committed with cool calculation and deliberate design with an eye on personal profit regardless of the consequence to the community. A disregard for the interest of the community can be manifested only at the cost of forfeiting the trust and faith of the community in the system to administer justice in an even handed manner without fear of criticism from the quarters which view white collar crimes with a permissive eye, unmindful of the damage; done to the National Economy and National Interest.

After Satyam scam, Indian regulators started working for the improvement in corporate governance of India. The SEBI is a main regulatory authority for India's stock market (Afsharipour, 2009). It proposed some regulations that should be strictly followed by all companies to maintain good governance standard. But, still India is at its nascent stage of corporate governance as it is evident by the frauds like Reebok, Sahara, Ranbaxy and the list goes on. The cornerstone of corporate governance is honesty, accountability and transparency. But, when we come to know about corporate failures, all these words seems to be ornamental.

The board of directors are said to be the mind and body of the company. They are under fiduciary relationship with the company, according to which they must take decisions with due care, skill and diligence. Most importantly, when there is conflict between director's own interest and the interest of the company, the director must give preference to the company's interest. But when we step into this corporate world, we see a different scenario in which directors give importance to their own interest in comparison to the company's interest which forces us to believe that 'greed' is the invention of all scams.

The other factors which contribute to these malpractices is unethical behavior of the directors. Honesty, trust, integrity are the main principles of ethics. In our childhood, our parents used to teach us what is right and what is wrong. But, as we grow older, our concept of ethics has been changed. Every common man has a dream to become rich but one should not forget "every flower has a thorn with it." In all the above frauds we have seen that directors have not missed a single opportunity of getting involved in unethical practices like cheating, conspiracy, bribery and dishonesty which ultimately becomes the reason of their downfall and of the company.

Therefore, there is a need of strict implementation of corporate governance norms along with ethics to be followed by these companies, not only for the sake of fulfillment of the requirements of the clause but for the benefit of the company."***it takes 12 hours to build a reputation of a company but only five minutes to ruin". (Warren Buffet).***

Suggestions

1. Ethical training should be given to the directors.
2. Awareness regarding environment protection should be taught.
3. Necessity of corporate governance system should be taught.

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