CHAPTER-IV
CORPORATE FRAUDS IN INDIA

Today everyone knows about corporate frauds in India. After the Satyam fraud, Sahara Estate Corp. fraud and Sharda Chit fund fraud has once again raised a finger on the existing legislations and regulatory authority. When the Harshad Mehta fraud was committed everyone was saying that there was not a regulatory authority to keep a watch on corporate world. Then SEBI was given power and a full fledge act was enacted in 1992. At that time we have also Security Contract and Regulation Act 1956 which have failed to prevent undesirable transaction. Then after it a lot of legislation has been enacted, but still frauds are rampant in India. These frauds have adversely affected the whole of nation. People till today avoid investing their money in companies. What a more pity it will be those who were given highest corporate award for good corporate governance later on within a year are found guilty of corporate fraud. Here I have discussed some of fraud and their affect on the society and reasons behind the fraud. They are-

4.1 Harshad Mehta Fraud

In the early 1990s, the banks in India had to maintain a particular amount of their deposits in government bonds. This ratio was called SLR (Statutory Liquidity Ratio). Each bank had to submit a detailed sheet of its balance at the end of the day and also show that there was a sufficient amount invested in government bonds. Now, the government decided that the banks need not show their details on each day, they need to do it only on Fridays. Also, there was an extra clause that said that the average percentage of bond holdings over the week needs to be above the SLR but the daily percentage needing not be so. That meant that banks would sell bonds in the earlier part of the week and then buy bonds back at the end of the week. The capital freed in the starting of the week could then be invested. Now, at the end of the week many banks would be desperate to buy bonds back. This is where the broker comes in. The broker knew which bank had more bonds and which has less

1 www.wikipedia.org visited on 02 august 2013.
than the required amount. He then acts as the middleman between the two banks. Harshad Mehta was one such broker. He worked as a middleman between many banks for a long time and gained the trust of the banks’ senior management.

Now since Harshad Mehta was dealing with many banks at the same time he could then keep some capital with him at all times. So he takes money from Bank. Now since Harshad Mehta was dealing with many banks at the same time he could then keep some capital with him at all times. For eg. He takes money from A on Monday, and tells B that he’ll pay on Tuesday, then he takes money from C on Tuesday and tells D that he’ll pay on Wednesday and the money he gets from C is paid to B and as a result he has some working capital with him at all times if this goes on with other banks throughout the week. The banks at that time were not allowed to invest in the equity markets. Harshad Mehta had very cleverly squeezed some capital out of the banking system. This capital he invested in the stock market and managed to stoke a massive boom. The crucial mechanism through which the fraud was effected was the ready forward (RF) deal. The ready forward is in essence a secured short-term (typically 15-day) loan from one bank to another. In this scheme the bank lends against government securities just as a pawnbroker lends against jewellery. The borrowing bank actually sells the securities to the lending bank and buys them back at the end of the period of the loan, typically at a slightly higher price. It was this ready forward deal that Mehta and his accomplices used to channel money from the banking system. The ready forward deal involved two banks which were brought together by a broker in lieu of a commission. The broker handles neither the cash nor the securities, though that wasn’t the case in the lead-up to the scam. In this settlement process, deliveries of securities and payments were made through the broker. The seller handed over the securities to the broker, who passed them to the buyer, while the buyer gave the cheque to the broker, who then made the payment to the seller. In this settlement process, the buyer and the seller might not even know whom they had traded with, either being known only to the broker. This the brokers could manage primarily because by now they had become market-makers and had started trading on their account.
Later on, they pretended to be undertaking the transactions on behalf of a bank.

Another instrument used was the Bank receipt. In a ready forward deal, securities were not moved back and forth. Instead, the borrower, i.e., the seller of securities, gave the buyer of the securities a Bank receipt. A Bank receipt “confirms the sale of securities. It acts as a receipt for the money received by the selling bank. It promises to deliver the securities to the buyer. It also states that in the mean time, the seller holds the securities in trust of the buyer.”

Having figured out his scheme, Mehta needed banks which issued fake BRs (Not backed by any government securities). “Two small and little known banks – the Bank of Karad (BOK) and the Metropolitan Co-operative Bank (MCB) – came in handy for this purpose. These banks were willing to issue BRs as and when required, for a fee. Once these fake BRs were issued, they were passed on to other banks and the banks in turn gave money to Mehta, assuming that they were lending against government securities when this was not really the case. This money was used to drive up the prices of stocks in the stock market. When time came to return the money, the shares were sold for a profit and the BR was retired. The money due to the bank was returned.

This went on as long as the stock prices kept going up, and no one had a clue about Mehta's operations. Once the fraud was exposed, though, a lot of banks were left holding BRs which did not have any value – the banking system had been swindled of a whopping ₹40 billion.

Exploiting several loopholes in the banking system, Mehta and his associates siphoned off funds from inter-bank transactions and bought shares heavily at a premium across many segments, triggering a rise in the Sensex. When the scheme was exposed, banks started demanding their money back, causing the collapse. He was later charged with 72 criminal offences, and more than 600 civil action suits were filed against him. He was arrested and banished from the stock market with investigators holding him responsible for causing a loss to various entities. Mehta and his brothers were arrested by the
CBI on 9 November 1992 for allegedly misappropriating more than 2.8 million shares (2.8 million) of about 90 companies, including ACC and Hindalco, through forged share transfer forms. The total value of the shares was placed at ₹2.5 billion (US$42 million).

Mehta made a brief comeback as a stock market guru, giving tips on his own website as well as a weekly newspaper column. However, in September 1999, Bombay High Court convicted and sentenced him to five years rigorous imprisonment and a fine of ₹ 25,000. On 14 January 2003, Supreme Court of India confirmed High Court's judgement. He died with many litigations still pending against him. He had altogether 28 cases registered against him. The trial of all except one, are still continuing in various courts in the country. Market watchdog, Securities and Exchange Board of India, had banned him for life from stock market-related activity. Mehta died of heart attack on 31st December 2001.

4.1(a) Reasons behind Frauds

It was in 1992 that market was collapsed. Harshad Mehta has taken advantage of loophole in the system. Moreover the banks were also negligent in dealing as they never try to find out whether the bank receipt issued was forged or not. Had the bank not negligent the fraud could have prevented. Harshad Mehta invested the money in equity market which was against the norm of bank. Banks were not allowed to invest the money in equity market. Bank of Karad and Metropolitan Cooperative bank does indirectly what they cannot do directly as they have issued fake bank receipt with the knowledge that Harshad Mehta is investing money in equity Market.

4.1(b) Effect of Fraud- Harshad Mehta fraud has affected the whole of nation. The Market was collapsed. Several investors have lost their money. The Government liberalization policy came into criticism and a voice was raised to create a regulatory bodies to keep a watch on corporate fraud and The SEBI was constituted.
4.2 M. S. Shoes Fraud in 1994

MS Shoes was a company established in Delhi, India in 1986 as an export house. It attracted large investments before collapsing in February 1995. Many investors lost large sums of money. The markets closed for three days after the crash.

Pawan Sachdeva took over his father's Delhi-based shoe export business, mostly serving Western Europe, and launched the company as MS Shoes in 1986. He raised money from investors and borrowed large sums from financial institutions and banks. Sachdeva used intriguing ads created by the Delhi branch of Rediffusion to attract investors. Shares were trading at Rs24 in 1993, and peaked at Rs502.5 in January 1995. Apparently the share prices had been manipulated. The Central Bureau of Investigation (CBI) started an investigation in 1995. In June 1997 the CBI sought permission from the government to lay charges against senior officials of the Securities and Exchange Board of India (SEBI) and SBI Capital Markets, a subsidiary of the State Bank of India. Sachdeva was charged with violating the Companies Act and the Prevention of Corruption Act. Later the CBI abandoned the probe due to lack of evidence, but in 2003 reopened the case. Many other civil and criminal charges were filed but the case is still pending in the court and Pawan Sachdeva is on bail.

SEBI was established in 1992. As in the case of Harshad Mehta the question which was raised that there was no regulatory authority to keep a eye on company. but it was only after 2 year of establishment of SEBI that a new fraud was committed and once again the investor has to lose their money and till today accused has not convicted.

4.2(a) Reasons for fraud- The share prices had been manipulated and SEBI has failed to discharge its duties.

4.2(b) Effect of Fraud- The Fraud has once again affected the whole nation. Question on the efficiency of SEBI was raised which was just created 3 year before the fraud and after the Harshad Mehta fraud. The markets had to be

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\[\text{En.wikipedia.org visited on 2}^{\text{nd}}\text{ august 2013 at 5 o clock}\]
closed for three days after this fraud. More than Rs2.7 billion was lost. once
again the investor has to lose their money

4.3 C.R. Bhansali Fraud 1997

Chain Roop Bhansali’s was a chartered accountant. He set up shell finance companies, make some accounts and balance sheets for them and sell them off to businessmen who needed such companies to rotate their black money. In 1985, Bhansali set up CRB Capital Markets, which started merchant banking operations, marketing public issues. Its list of clients was insignificant and the fly-by-night, but that list was longer than any other merchant banker's in the country. Naturally, since Bhansali was willing to handle any issue at all. By 1994, Bhansali was ready to get into a bigger business: mutual funds. SEBI gave him the nod, in 1994, he launched the CRB Arihant Mangal Fund and, raised something around Rs 230 crore funds. Out of the amount It was only Rs 6.25 crore came from small investors. Now the question arises where did the rest come from? Bhansali rounded up his pals in a quid pro quo deal. They routed their money into Bhansali’s mutual fund, which routed it back to them by buying shares in their companies from them. By now Bhansali was getting really ambitious. The next step which he has taken for money making was to set up a bank. The merchant banking division would manage shady share issues, raising money from the unsuspecting public and rerouting crooked promoters' funds. Many of these companies would anyway be finance companies which would redirect money into Bhansali's NBFC and mutual fund. With the bank in operation, Bhansali would have access to more public savings than ever before, and that circle would reach its apogee, moving funds faster and faster, wider and wider. CRB got the RBI in principle approval to set up his bank in Bhubaneshwar. Why he got it when applicants like the Tatas and Birlas (Aditya Birla group) were refused a banking license, is unanswered question. Then in November 1996, a routine RBI inspection revealed that the CRB group was misusing public funds and misreporting income. The RBI withdrew its banking approval, but Bhansali coolly issued his Esteem Bonds, and raised money to actually feed

3 Something for something.
the promoter's contribution in his bank. He needed more and more money to feed his cycle, and his supplies were not matching his demand, for once the cycle is set in motion, it's hard to get off. He started offering absurd incentives for making FDs in his company and began borrowing at exorbitant rates from the inter-corporate market. Much of that money would go into servicing his depositors, paying back their principal and interest. The cycle was fast turning vicious, and the only way he could have saved his empire was to set up the bank and mobilise a new large source of cheap funds. That did not happen. So he tried the last trick in his book. CRB serviced its depositors through the SBI. The company paid SBI the money required in advance every three months, and against this, the SBI would encash the interest warrants and refund orders that CRB depositors sent the bank. In February, CRB quietly stopped making the advance payments. No one in the SBI seemed to have noticed. That the SBI suddenly was covered with redemption requests points to a colluded conspiracy to defraud the bank. The bank kept encashing the cheques till the figure hit the Rs 60 crore mark, when someone sat up and took notice. Then the cheques started bouncing, and the faucal matter hit the air generator. Chain Roop Bhansali is, however, still absconding.

4.3(a) Loopholes of which C. R. Bhansali took Advantage

Rating agency stated in its report that CRB had liquidity problems, defaulted on loans, and that its asset quality was deteriorating. After RBI stopped CRB from raising fresh FDs; CARE, which claims to have been monitoring CRB all through, woke up and downgraded its rating quickly to C, denoting high investment risk. The auditors of the Company never pointed out any irregularities in CRB’s operations. The company-auditor nexus is suspected to be fairly common in the country's financial services industry. The RBI gave an in-principle banking license to CRB, a rare honour. The RBI inspection showed massive irregularities, but did nothing about it while CRB happily went on collecting FDs. In December, RBI put the banking license on hold, but turned a blind eye to CRB raising money for its bank. Only when reports started appearing in the media in April did RBI cancel the license and stop CRB from collecting FDS. The SEBI remained a bystander.
while CRB managed scores of shady share issue to become the number one merchant banker in the country. SEBI gave CRB permission to start a mutual fund and a share custodial service. In April 1996, when SEBI discovered irregularities in CRB’s mutual fund, it barred it from launching any new schemes. For just two months. THE SBI CRB's depositors encashed their interest warrants and refund orders through SBI. CRB was supposed to deposit the amounts in advance with SBI every three months. In February, CRB stopped this pre-funding and continued to issue warrants and orders, which SBI faithfully honoured, perhaps reassured by the fact that a former SBI chief was on the CRB board. Only when the unpre-funded payouts hit a staggering Rs 60 crore did the bank wake up.

4.3(b) Effect of Fraud- Once again investor’s faith was broken and they have no option for returning their money back. Here if the SEBI and Auditors would have alert fraud would not have committed. Due to this fraud many of the investor has become insolvent and committed suicide.

4.4 Ketan Parekh Fraud† 2001

Ketan Parekh [KP] was a chartered accountant by profession and used to manage a family business, NH Securities started by his father. Known for maintaining a low profile, KP's only dubious claim to fame was in 1992, when he was accused in the stock exchange scam. He was known as the 'Bombay Bull' and had connections with movie stars, politicians and even leading international entrepreneurs like Australian media tycoon Kerry Packer, who partnered KP in KPV Ventures, a $250 million venture capital fund that invested mainly in new economy companies. Over the years, KP built a network of companies, mainly in Mumbai, involved in stock market operations.

The 176-point Sensex crash on March 1, 2001 came as a major shock for the Government of India, the stock markets and the investors alike. More so, as the Union budget tabled a day earlier had been acclaimed for its growth initiatives and had prompted a 177-point increase in the Sensex. This sudden

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† [www.srimca.edu.in](http://www.srimca.edu.in) visited on 2nd august at 5 o clock
crash in the stock markets prompted the Securities Exchange Board of India (SEBI) to launch immediate investigations into the volatility of stock markets. SEBI also decided to inspect the books of several brokers who were suspected of triggering the crash. Meanwhile, the Reserve Bank of India (RBI) ordered some banks to furnish data related to their capital market exposure. This was after media reports appeared regarding a private sector bank having exceeded its prudential norms of capital exposure, thereby contributing to the stock market volatility. The panic runs on the bourses continued and the Bombay Stock Exchange (BSE) President Anand Rathi's resignation added to the downfall. Rathi had to resign following allegations that he had used some privileged information, which contributed to the crash. The scam shook the investor's confidence in the overall functioning of the stock markets. By the end of March 2001, at least eight people were reported to have committed suicide and hundreds of investors were driven to the brink of bankruptcy.

The scam opened up the debate over banks funding capital market operations and lending funds against collateral security. It also raised questions about the validity of dual control of co-operative banks. The first arrest in the fraud was of Ketan Parekh (KP), on March 30, 2001, by the Central Bureau of Investigation (CBI). He was charged with defrauding Bank of India (BoI) of about $30 million among other charges. KP's arrest was followed by yet another panic run and the Sensex fell by 147 points. By this time, the scam had become the 'talk of the nation,' with intensive media coverage and unprecedented public outcry.

According to market sources, though Ketan Parekh [KP] was a successful broker, he did not have the money to buy large stakes. According to a report 12 lakh shares of Global in July 1999 would have cost KP around Rs 200 million. The stake in After Infosys would have cost him Rs 50 million, while the Zee and HFCL stakes would have cost Rs 250 million each. Analysts claimed that KP borrowed from various companies and banks for this purpose. His financing methods were fairly simple. He bought shares when they were trading at low prices and saw the prices go up in the bull market while continuously trading. When the price was high enough, he
pledged the shares with banks as collateral for funds. He also borrowed from companies like HFCL. This could not have been possible out without the involvement of banks. A small Ahmedabad-based bank, Madhavapura Mercantile Cooperative Bank (MMCB) was KP’s main ally in the scam. KP and his associates started tapping the MMCB for funds in early 2000. In December 2000, when KP faced liquidity problems in settlements he used MMCB in two different ways. First was the pay order route, wherein KP issued cheques drawn on BoI to MMCB, against which MMCB issued pay orders. The pay orders were discounted at BoI. It was alleged that MMCB issued funds to KP without proper collateral security and even crossed its capital market exposure limits. As per a RBI inspection report, MMCB’s loans to stock markets were around Rs 10 billion of which over Rs 8 billion were lent to KP and his firms. The second route was borrowing from a MMCB branch at Mandvi (Mumbai), where different companies owned by KP and his associates had accounts. KP used around 16 such accounts, either directly or through other broker firms, to obtain funds. Apart from direct borrowings by KP-owned finance companies, a few brokers were also believed to have taken loans on his behalf. It was alleged that Madhur Capital, a company run by Vinit Parikh, the son of MMCB Chairman Ramesh Parikh, had acted on behalf of KP to borrow funds. KP reportedly used his BoI accounts to discount 248 pay orders worth about Rs 24 billion between January and March 2001. BoI's losses eventually amounted to well above Rs 1.2 billion.

The MMCB pay order issue hit several public sector banks very hard. These included big names such as the State Bank of India, Bank of India and the Punjab National Bank, all of whom lost huge amounts in the scam. It was also alleged that Global Trust Bank (GTB) issued loans to KP and its exposure to the capital markets was above the prescribed limits. According to media reports, KP and his associates held around 4-10% stake in the bank. There were also allegations that KP, with the support of GTB’s former CMD Ramesh Gelli, rigged the prices of the GTB scrip for a favorable swap ratio before its proposed merger with UTI Bank. KP's modus operandi of raising funds by offering shares as collateral security to the banks worked well as
long as the share prices were rising, but it reversed when the markets started crashing in March 2000. The crash, which was led by a fall in the NASDAQ⁵, saw the K-10 stocks also declining. KP was asked to either pledge more shares as collateral or return some of the borrowed money. In either case, it put pressure on his financials. By April 2000, mutual funds substantially reduced their exposure in the K-10 stocks. In the next two months, while the Sensex declined by 23% and the NASDAQ by 35.9%, the K-10 stocks declined by an alarming 67%. However, with improvements in the global technology stock markets, the K-10 stocks began picking up again in May 2000. HFCL nearly doubled from Rs 790 to Rs 1,353 by July 2000, while Global shot up to Rs 1,153. Aftek Infosys was also trading at above Rs 1000.

In December 2000, the NASDAQ crashed again and technology stocks took the hardest beating ever in the US. Led by doubts regarding the future of technology stocks, prices started falling across the globe and mutual funds and brokers began selling them. KP began to have liquidity problems and lost a lot of money during that period. It was alleged that 'bear hammering' of KP's stocks eventually led to payment problems in the markets. The Calcutta Stock Exchange's (CSE) payment crisis was one of the biggest setbacks for KP. The CSE was critical for KP's operation due to three reasons. One, the lack of regulations and surveillance on the bourse allowed a highly illegal and volatile badla business Two, the exchange had the third-highest volumes in the country after NSE and BSE. Three, CSE helped KP to cover his operations from his rivals in Mumbai. Brokers at CSE used to buy shares at KP's behest. Though officially the scrips were in the brokers' names, unofficially KP held them. KP used to cover any losses that occurred due to price shortfall of the scrips and paid a 2.5% weekly interest to the brokers.

By February 2001, the scrips held by KP's brokers at CSE were reduced to an estimated Rs 6-7 billion from their initial worth of Rs 12 billion. The situation worsened as KP’s badla payments of Rs 5-6 billion were not honored on time for the settlement and about 70 CSE brokers, including

⁵ It is a stock exchange situated in New York, U.S.A
the top three brokers of the CSE defaulted on their payments. By mid-March, the value of stocks held by CSE brokers went down further to around Rs 2.5-3 billion. The CSE brokers started pressurizing KP for payments. KP again turned to MMCB to get loans. The outflow of funds from MMCB had increased considerably form January 2001. Also, while the earlier loans to KP were against proper collateral and with adequate documentation. KP was allowed to borrow without any security.

By now, SEBI was implementing several measures to control the damage. An additional 10% deposit margin was imposed on outstanding net sales in the stock markets. Also, the limit for application of the additional volatility margins was lowered from 80% to 60%.

To revive the markets, SEBI imposed restriction on short sales and ordered that the sale of shares had to be followed by deliveries. It suspended all the broker member directors of BSE's governing board. SEBI also banned trading by all stock exchange presidents, vice-presidents and treasurers. A historical decision to ban the badla system in the country was taken, effective from July 2001, and a rolling settlement system for 200 Group A shares was introduced on the BSE.

Many exchanges were not happy with the decision of banning the badla system as they felt it would rig the liquidity in the market. Analysts who opposed the ban argued that the ban on badla without a suitable alternative for all the scrips, which were being moved to rolling settlement, would rig the volatility in the markets. They argued that the lack of finances for all players in the market would enable the few persons who were able to get funds from the banking system - including co-operative banks or promoters - to have an undue influence on the markets.

KP was released on bail in May 2001. The duped investors could do nothing knowing that the legal proceedings would drag on; perhaps for years the KP scam had set back the Indian economy by at least a year. It was

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Badla was carry forward system invented by BSE as a solution to perpetual lack of liquidity in secondary market. But now these are banned in 2001 by following the introduction of future contract in 2000.
widely believed that more than a fraud; KP was an example of the rot that was within the Indian financial and regulatory systems. If the regulatory authorities had been alert, the huge erosion in values could have been avoided or at least controlled. After all, Rs 2000 billion is definitely not a small amount even for a whole nation.

4.4(a) Reasons for Fraud- The small investors who lost their life's savings felt that all parties in the functioning of the market were responsible for the scams. They opined that the broker-banker-promoter nexus, which was deemed to have the acceptance of the SEBI itself, was the main reason for the scams in the Indian stock markets. SEBI's measures were widely criticized as being reactive rather than proactive. SEBI's market intelligence was very poor. Moreover KP's arrest was also not due to the SEBI's timely action but the result of complaints by BoI.

4.4(b) Effect of Fraud- India has lost 200 billion. Many investors have committed suicide and hundreds of investors were driven to brink of bankruptcy. The Fraud shook the investor’s confidence in the overall functioning of stock markets. Badla system was banned.

4.5 Satyam Fraud 2008

Satyam means truth, but Rs. 7,000 Grote scam is the largest corporate scam confessed by Satyam Computers. Satyam is the country's fourth largest IT company after ICS, Infosys and Wipro. It was cooking its books for last several years by inflating its revenues and profits. It boosted Its cash and bank balance and showed interest income which did not actually exist and overstated its debtors to promote its sales figures.

Ramalinga Raju is the company's promoter Chairman based at Hyderabad. He kept lying the company's financial position to its shareholders, employees and public around the globe. On 7th January, 2008, Wednesday, the scam was unfolded when confession was made to SEBI which knocked down the stuck market and created a black shadow over the industrial sector, particularly the IT sector. Questions were raised about corporate governance, role of auditors and independent directors.
Most of the shareholders made an exit from the share market and by the end of the day. It drove the stock market down by 78%. Doubts over financial health and corporate governance of sense constituents resulted in panic selling and experienced the 10th worst fall in the stock market index (down by 749 points) since the 30-share index was launched in 1986. In order to cover the misdeeds, Raju wanted to sell out 51.6 billion to acquire his sons companies, Maras Properties and Maytas Infra. He wanted to make fictitious cash transfers to come out of the financial scam. Merrill Lynch, the company's financial advisor, terminated its agreement with Satyam to advise it on strategic options because of material accounting irregularities. By the end of Wednesday, there was huge hue and cry by investors to probe against Raju, Satyam and its auditors with SEBI, the Exchanges, ICA and department of company.

In his letter to the Satyam Board, Ramalinga Raju said. 'neither myself nor the management director, (including our spouses) sold any shares in the last eight years excepting for a small proportion declared and sold for philanthropic purposes' The promoters wanted to suggest that they have not sold the shares of the company for several years and, therefore, have not benefited from inflating the share price by overstating its performance. Despite the claim, however the fact remained that promoters holding fell to 8.2% of the total equity by June 2006 from 25.6% of the total shares of the company in March 2001. It fell from 7.2 crore shares to 3 crore shares during the same period. The promoters realised more than Rs. 1.000 crore from sale of shares at the time when average share price of the company was about it. 700. The share price was about its. 225 in mid-December, 2007 and on Wednesday, the 7th January, 2008 the share price fell to Its. 40. It becomes difficult to accept from these figures that Raju's have not gained from inflated results. The Chairman, Ramalinga Raju has admitted that the company had been cooking figures in its financial statements and showing higher revenues and lower liabilities. It has been overstating its profits and reserves. From September 2007 to December 2008, the company's bank balance was overstated by Rs. 5.040 crore and accrued interest by Rs. 376 crore. Liabilities were understated by its. 1,720 crore. Thus, the overall financial statement was
overstated by Rs. 7,136 crore. The purpose of the scam was to keep the financial position of the company look good. As the promoters had a small percentage of equity, the poor performance of the company could result in a takeover. It was, therefore, important that the company was presented as a growing company. Acquisition of Maytas, a real estate firm owned by Raju's family was seen as the last attempt to fill company's fictitious assets with real ones. Investors of Maytas viewed it as a good divestment opportunity. Maras was proposed to be bought for about Rs. 6,400 crore and turned into a wholirovated subsidiary of Satyam. It was hoped that payment to Maytas could be delayed. Since payment had to be made to Maras, which was owned by Raju family, for its shares only on paper. Rs. 6,400 crore would move out from Satyam's books into Raju family's hands. Satyam would have acquired Maytas, in turn. The payment was just a formality where Raju family technically received Rs. 6,400 crore. This would result in Satyam's inflated reserves and surplus to come down to actual level without showing that the books were overstated. The Raju family would have actually got much less than Rs 6,400 crore but then, they would not complain and nobody but Raju family would know about this. It would only result in passing of nonexistent reserve of Satyam to Maras to deflate the inflated figures in Satyam's books. However, investors created a furore over the proposed merger as they felt that Maytas was being purchased at an overvalued figure. This closed the opportunity for Satyam to engage in bungling with Satrun's paper transfers. The initial investigations by the Registrar of Companies into the Satyam scam has revealed large-scale selling of the company's shares by institutional investors just days ahead of Ramalinga Raju's confession of manipulating Company accounts. Highly placed official sources said. The Serious Fraud Investigation Office, (SF10) would closely scrutinize some of these transactions since they have raised the suspicion of possible insider trading.

The sales took place after the Satyam-Maytas merger fiasco which, too, might have encouraged these big players to exit the IT major. The sources said five salts between December 23 and January 5, totaling 2.45 crore shares are particularly under the scanner. These sales were all involving shares pledged by the Raju family with various entities to raise loans. That
means he was showing a cash at hand to be 5000 crores about a billion dollars whereas the cash is only 640 crores or even less in the accounts. That letter caused a stir and the jobs of about 55000 employees are at stake as well as the whole future of the company is at stake.

Satyam is saying that the profit margin is only 3% which is very hard to believe and hence the big question is where is the money and the reason for overstating the profits and the cash in hand.

The problem is why Satyam has such low profit margins which means that there are more employees than there is work and secondly if indeed the revenue is that much then why the profit margin is less and if it is same as other companies the where did the money go? The auditors internal as well as external should have known this. Internal auditors can be hand in glove with the management but what happened to the external auditors as to why they did not suspect something wrong.

In this the case the external auditors were PWC or Price Water House Coopers and that means PWC knew about the fraud all along or they did not do proper auditing. In fact they were paid much more than what other Indian IT companies paid their auditors.

This is the irony of the situation that a company which was considered the best in IT industry has such low corporate governance standards. On top it the Board of Directors were not even apprised of even anything. The ongoing investigations into the Satyam scam which made news early in 2009, showed that show that several top level directors are also guilty of fraud.

4.5(a) Reasons for Fraud- The central bureau of Investigation (CBI) said in a report that the members of the Board of Directors had acted as “rubber stamps”, unwilling to oppose the fraud. Not a single not of dissent has been recorded in the minutes of the Board meetings. The scam was unearthed when investigators found manual entries being made to record fraudulent sales. The investigators then set out to locate the authors of these “fake” invoices. Early into the investigations, the CBI found that the guilty were also extremely smart, tabulating balance sheets using computers that could not be tracked.
Office data showed that a few officers would make entries late in the night, toward the last quarter of the month. The manipulated balance sheets were thus created. And auditors didn’t discharge their duty properly.

4.5(b) Effect of fraud- The fraud affected the whole of nation and many investors have committed suicide. And around 45,000 employees were left jobless, huge losses were incurred on the investors and creditors of the company, and the stock market collapsed with the Sensex falling by nearly 750 points.

4.6 Sahara India Real Estate Corp Ltd. vs. SEBI 2012

The Supreme Court on 31st August, 2012 has directed the Sahara Group and its two group companies Sahara India Real Estate Corporation Limited (SIRECL) and Sahara Housing Investment Corporation Limited (SHICL) to refund around Rs 17,400 crore to their investors within 3 months from the date of the order with an interest of 15\%\textsuperscript{7}. The Supreme Court while confirming the findings of the SAT has further asked SEBI to probe into the matter and find out the actual investor base who have subscribed to the Optionally Fully Convertible Debentures (OFCDs) issued by the two group companies SIRECL and SHICL\textsuperscript{8}.

Shareholders of SIRECL approved a resolution u/s 81(1A) for raising funds by issuance of Optionally Fully Convertible Debentures (OFCDs) on private placement basis. The company filed Red herring prospectus with the RoC and it specifically stated that it did not intend to list the shares on any Stock exchange. The main intention of raising funds was to finance infrastructural activities. It circulated the Information Memorandum (IM) to friends, associate companies, Workers/employees. It collected huge sums of money amounting to about 19400 crores. In a similar way its other group company SHIC also raised funds. SEBI on the basis of a complaint, issued a notice to Sahara and called for information on the OFCDs issued by Sahara. Sahara refused to give information on the ground that SEBI had no locus standi to call for such information. SEBI had to issue summons calling for

\textsuperscript{7} The Times of India, 1st Sept 2012
\textsuperscript{8} Ibid
information as interest of investors was involved. Ministry of Corporate Affairs(MCA) had also called for information and informed SEBI that it found compliances in respect of certain queries but advised Saharas to file prospectus as per Section 60 B(9) of the Companies Act, 1956.

SEBI issued a show cause notice alleging that issuance of OFDS was a public issue as it involved more than 50 persons and, therefore, securities were liable to be listed on a recognized stock exchange under Section 73 of the Companies Act.\(^9\) The SEBI passed an order directing the two companies to refund the money so collected to the investors and also restrained the promoters of the two companies including Mr. Subrata Roy from accessing the securities market till further orders. Sahara then preferred an appeal before SAT against the order of SEBI and after hearing, The SAT confirmed and maintained the order. Subsequently Sahara filed an appeal before the Supreme Court of India against the SAT order.

Following Issues were raised in this case\(^10\):

First issue which was raised in the case was whether SEBI has the power to investigate and adjudicate in this matter as per Sec 11, 11A, 11B of SEBI Act and under Sec 55A of the Companies Act. Or is it the Ministry of Corporate Affairs (MCA) which has the jurisdiction under Sec 55A (c) of the Companies Act?

Second issue which was raised is that whether the hybrid OFCDs fall within the definition of "Securities" within the meaning ofCompanies Act, SEBI Act and SCRA so as to vest SEBI with the jurisdiction to investigate and adjudicate?

The Next issue which was raised is the issue of OFCDs to millions of persons who subscribed to the issue is a Private Placement so as not to fall within the purview of SEBI Regulations and various provisions of Companies Act?

\(^9\) The Indian Companies Act 2013.
\(^10\) [www.mondaq.com](http://www.mondaq.com) visited on 26th June 2014 at 7 A.M
Another issue which was raised is whether listing provisions under Sec 73 mandatorily applies to all public issues or depends upon the "intention of the company" to get listed.

Another question which was raised was whether the Public Unlisted Companies (Preferential Allotment Rules) 2003 will apply in this case. The companies also argued that as per the Unlisted Public Companies (Preferential Allotment) Rules 2003, preferential allotment by unlisted public companies on private placement was provided for and permitted without any restriction on numbers as per the proviso to Section 67(3) of the Companies Act and without requiring listing of such OFCDs on a recognized stock exchange. They went on to argue that Sec 67(3) was made applicable to Preferential Allotment made by unlisted public companies only in 2011 by amending the 2003 rules with prospective effect and not with retrospective effect. Hence before the 2011 Rules were framed, they were free to make preferential allotment to more than 50 persons also.

The Supreme Court held that SEBI have power to investigate and adjudicate in this matter. The SEBI Act is a special legislation Conferring SEBI with special powers to investigate and adjudicates to protect the interests of the investors. It has special powers and its powers are not derogatory to any other provisions existing in any other law and are analogous to such other law and should be read harmoniously with such other provisions and there is no conflict of jurisdiction between the MCA and the SEBI in the matters where interests of the investors are at stake. The Supreme Court laid further emphasis on the legislative intent and the statement of objectives for the enactment of SEBI Act and the insertion of Section 55A in the Companies Act to delegate special powers to SEBI in matters of issue, allotment and transfer of securities. The Court held that as per Section 55A of the Companies Act, so far matters relate to issue and transfer of securities and non-payment of dividend, SEBI has the power to administer in the case of listed public companies and in the case of those public companies which intend to get their securities listed on a recognized stock exchange in India.
The Supreme Court further held that although the OFCDs issued by the two companies are in the nature of "hybrid" instruments, it does not cease to be a "Security" within the meaning of Companies Act, SEBI Act and SCRA. It says although the definition of "Securities" under section 2(h) of SCRA does not contain the term "hybrid instruments", the definition as provided in the Act is an inclusive one and covers all "Marketable securities". As in this case such OFCDs were offered to millions of people there is no question about the marketability of such instrument. And since the name itself contains the term "Debenture", it is deemed to be a security as per the provisions of Companies Act, SEBI Act and SCRA.

The Supreme Court went on to hold that although the intention of the companies was to make the issue of OFCDs look like a private placement, it ceases to be so when such securities are offered to more than 50 persons. Section 67(3) specifically lays down that when any security is offered to and subscribed by more than 50 persons it will be deemed to be a Public Offer and therefore SEBI will have jurisdiction in the matter and the issuer will have to comply with the various provisions of the legal framework for a public issue. Although the Sahara companies contended that they are exempted under the provisos to Sec 67 (3) since the Information memorandum specifically mentioned that the OFCDs were issued only to those related to the Sahara Group and there was no public offer, the Supreme Court however did not agree with this argument. It further held that the companies elicited public demand for the OFCDs through issue of Information Memorandum under Section 60B of the Companies Act, which is only meant for Public Issues. The Supreme Court also held that since introducers were needed for someone to subscribe to the OFCDs, it is clear that the issue was not meant for persons related or associated with the Sahara Group because in that case an introducer would not be required as such a person is already associated or related to the Sahara Group. Thus the Supreme Court held that the actions and intentions on the part of the two companies clearly show that they wanted to issue securities to the public in the garb of a private placement to bypass the various

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11 www.topcafirms.com visited on 25th June 2014 at 2 p.m.
laws and regulations in relation to that. The Court laid down that the Sahara Companies have issued securities to more than the threshold statutory limit fixed under proviso to Section 67(3) and hence violated the listing provisions attracting civil and criminal liability. The Supreme Court also observed that issue of OFCDs through circulation of IM to public attracted provisions of Section 60B of the Companies Act, which required filing of prospectus under Section 60B(9) and since the companies did not come out with a final prospectus on the closing of the offer and failed to register it with SEBI, the Supreme Court held that there was violation of sec 60B of the Companies Act also.

The Supreme Court held that although Sahara argued that listing requirement under Sec 73 of Companies Act is not mandatory and applies to those companies only who "intend to get listed", no company can be forced to get listed on a stock exchange and in such cases it will be a violation of corporate autonomy. The Supreme Court rejected this contention and held as long as the law is clear and unambiguous, and any issue of securities is made to more than 49 persons as per Sec 67(3) of the Companies Act, the intention of the companies to get listed does not matter at all and Sec 73 (1) is a mandatory provision of law which companies are required to comply with. The Supreme Court observed that Section 73(1) of the Act casts an obligation on every company intending to offer shares or debentures to the public to apply on a stock exchange for listing of its securities. In addition the Supreme Court observed that the maxim "acta exterior indicant interiora secreta" (external action reveals inner secrets) applies with all force in the case of Saharas. The Court observed that the contention that they did not want their securities listed does not stand. The duty of listing flows from the act of issuing securities to the public, provided such offer is made to fifty or more than fifty persons. Any offering of securities to fifty or more is a public offering by virtue of Section 67(3) of the Companies Act, which the Saharas very well knew, their subsequent actions and conducts unquestionably reveal so.

Ibid.
However, the Supreme Court did not agree with the argument of Sahara group and held that the legislative intent was not so, and such a Rule being a delegated piece of legislation cannot supersede the statutory provisions of Sec 67(3) and in the existence of Sec 67(3) it is implied that even the 2003 preferential allotment rules were required to comply with the requirement of Sec 67(3). The Supreme Court observed that Even if armed with a special resolution for any further issue of capital to person other than shareholders, it can only be subjected to the provisions of Section 67 of the Company Act, that is if the offer is made to fifty persons or more, then it will have to be treated as public issue and not a private placement. The Court observed that 2003 Rules apply only in the context of preferential allotment of unlisted companies; however, if the preferential allotment is a public issue, then 2003 Rules would not apply. Next issue which was raised was whether OFCDs are Convertible Bonds and whether exempted from application of SCRA as per the provisions of sec 28(1)(b). The two Sahara companies also contended that the OFCDs being in the nature of Convertible bonds issued on the basis of the price agreed upon at the time of issue and, therefore, the provisions of SCR Act are not applicable in view of Section 28(1)(b) thereof and therefore SEBI will have no jurisdiction. The Supreme Court rejected this contention and held that the amendment in the SCRA was made and subsequently Sec 28 was inserted to exempt convertible bonds by foreign financial institutions that had an option to obtain shares at a later date. The Supreme Court further held that the inapplicability of SCRA, as contemplated in Section 28(1)(b), is not to the convertible bonds, but to the entitlement of a person to whom such share, warrant or convertible bond has been issued, to have shares at his option. The Act is, therefore, inapplicable only to the options or rights or entitlement that are attached to the bond/warrant and not to the bond/warrant itself. The Supreme Court clarified by saying that 28(1)(b), clearly indicates that it is only the convertible bonds and
share/warrant of the type referred to therein that are excluded from the applicability of the SCRA and not debentures which are separate category of securities in the definition contained in Section 2(h) of SCRA. Supreme Court dismissed the appeal and upheld the orders passed by SEBI and SAT. It appointed Mr. Justice B N Agarwal to oversee the activities for effective implementation of the directions the court. It ordered Sahara to refund of the entire amount collected through RHP with interest of 15% till the date of refund. Such refund amount be deposited an interest bearing deposit a/c with a nationalize bank and authorised SEBI to take legal recourse, if Sahara fails to comply with the directions

4.6(a) Reasons for Fraud – Sahara Group has taken advantages of loopholes in existing law. This group has violated and manipulated various law.

4.6(b) Effect of Judgement- This landmark Judgment is a milestone in India's Corporate world, as it not only sanctifies SEBI's absolute power to investigate into the matters of listed companies, but also into the matters pertaining to the unlisted companies. It vests SEBI with powers to investigate into any matter concerning the interest of the investors even if it pertains to companies which are not listed. It clarifies significant points of law and removes the grey areas relating to issue of securities by the so called unlisted companies taking advantage of the loopholes of law. Also, in the matters of jurisdiction, this Judgment has bridged the jurisdictional gap which previously existed between that of the Ministry of Corporate Affairs and SEBI. Sahara has already filed a review petition against this judgment before the Supreme Court. In a public statement they have also said even if the review petition fails, they will challenge the same vide a curative petition before the Supreme Court. Whether Sahara gets any relief in the near future remains to be seen. It however, seems to be a tough legal battle ahead of them. This will act as a deterrent on those unscrupulous promoters who raise
huge money in the name of savings from public who are unaware of the risks involved in such investments. In this case the fight given by SEBI to protect the interests of small investors is commendable.

4.7 Sharada Chit Fund Fraud 2013

A chit fund is a kind of savings scheme practiced in India. A chit fund company is a company that manages, conducts, or supervises a chit scheme. According to Section 2(b) of the Chit Fund Act, 1982:

"Chit means a transaction whether called chit, chit fund, chitty, kuree or by any other name by or under which a person enters into an agreement with a specified number of persons that every one of them shall subscribe a certain sum of money (or a certain quantity of grain instead) by way of periodical installments over a definite period and that each such subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit agreement, be entitled to the prize amount".

Such chit fund schemes may be conducted by organised financial institutions, or may be unorganised schemes conducted between friends or relatives. In some variations of chit funds, the savings are for a specific purpose.

In the Case of the Saradha Group financial fraud a consortium of over 200 private companies were running a wide variety of collective investment schemes which were referred to as chit fund. The group of company collapsed in April 2013, causing an estimated loss of 1000 crore to over 1.7 million depositors.

The companies that formed Saradha Group were incorporated in 2006. Its name is a cacography of Sarada Devi, a highly revered spiritual icon of the region and the wife and spiritual counterpart of Ramakrishna Paramahamsa, a
nineteenth-century mystic of Bengal\textsuperscript{13}. This association gave Saradha Group a veneer of respectability\textsuperscript{14}.

Money Collected by Sharda Group\textsuperscript{15}

![Money Collected by Sharda Group](chart.png)

Money collected by Sharda Group of Companies per year in billion INR. 95\% of the fund was collected in the last three years of the scam.

Like all Ponzi schemes, Saradha Group promised astronomical returns in fanciful but credible investments\textsuperscript{16}. Its funds were sold on commission by agents who were recruited from local rural communities. As much as 25–40\% of the deposit was returned to these agents as commissions and lucrative gifts to quickly build up a wide agent pyramid. To keep ahead of regulators, the group used a nexus of companies to launder money.

These companies collected money from the public by issuing secured debentures and redeemable preferential bonds. However, under Indian Securities regulations and the Indian Companies Act, 1956 a company cannot

\begin{itemize}
  \item \textsuperscript{13} \url{en.wikipedia.org} visited on 23\textsuperscript{rd} Sept 2014
  \item \textsuperscript{14} Ibid.
  \item \textsuperscript{15} Ibid.
  \item \textsuperscript{16} Ibid.
\end{itemize}
raise capital from more than 50 people without issuing a proper prospectus and
balance sheet and its accounts must be audited. It must have obtained
permission from the Securities and Exchange Board of India (SEBI). Then
only after complying with these provisions a company can issue securities. But
this group has violated all the provision Companies Act as it has issues
debentures and bond without issuance of prospectus and without obtaining the
permission from SEBI.

SEBI first time challenged this Group in 2009. This Group responded
to SEBI by opening as many as 200 new companies to create more cross-
holdings. This created an extremely complex tiered corporate structure which
made it difficult to pin blame on any one company\(^\text{17}\). This was done to evade
legal provision.

However, SEBI persisted in its investigation through 2010. In
response, Saradha Group changed its methods of raising capital. In West
Bengal, Jharkhand, Assam and Chhattisgarh, it now ran variations of
collective investment schemes (CIS), such as tourism packages, forward travel
and hotel booking timeshare credit transfer, real estate, infrastructure finance,
and motorcycle manufacturing\(^\text{18}\). The investors were not given any
information about the nature of the investments. Moreover many investors
were told only that they would get high returns after a fixed period. To other
investors, the investment was fraudulently sold as a form of `chit fund'. Chit
funds are regulated by state governments under The Chit Fund Act.

When SEBI warned the state government of West Bengal about
Saradha Group's apparent chit fund activities in 2011 Saradha Group changed
its methods again. This time, it acquired and sold large numbers of shares of
various listed companies, siphoning off the proceeds of the sale to accounts
which have not yet been identified\(^\text{19}\). Around this period Saradha Group

\(^{17}\) Ibid
\(^{18}\) The Times of India, 17\(^{th}\) April 2013
\(^{19}\) www.wikipedia.com visited on 17\(^{th}\) April 2013.
started laundering a large portion of its funds to Dubai, South Africa and Singapore\textsuperscript{20}.

By 2012, SEBI was able to identify the group's activities as CIS, not chit fund, and demanded that it immediately stop operating its investment schemes until it received proper permission from SEBI. However, Saradha Group ignored SEBI, and continued to operate in the same manner until it collapsed in April 2013. In April 2013, Sudipto Sen wrote a confessional letter to the Central Bureau of Investigation, in which he admitted that he had paid large sums of money to several politicians. After posting this letter Sen fled.

In his absence, the Ponzi scheme unravelled into a full-blown crisis. On 17 April, 2013 approximately 600 collection agents claiming to be associated with Saradha Group assembled at the headquarters of TMC and demanded government intervention\textsuperscript{21}.

4.7(a) Reasons Behind Fraud – Political Patronage, lack of financial literacy and investor awareness, absence of adequate legal deterrence are the reason for fraud.,

4.7(b) Effects of Fraud- The Saradha scam came into highlight after the collapse of a Ponzi scheme run by the Saradha group, a consortium of over 200 companies running a wide variety of collective investment schemes mainly in West Bengal, Assam and Odisha. The group collapsed in April 2013, causing an estimated loss of about Rs. 10,000 crore to over 1.7 million depositors. The entire Dakshin Bahart today looks like it was hit by a cyclone\textsuperscript{22}. Every home has a bankrupt depositor or a fugitive agent\textsuperscript{23}. People who were friends have turned enemies. Happy households have become miserable. Students have stopped going to school. Traders have lost interest in opening shutters. There is a sense of treachery that has replaced the warmth of a neighbourhood\textsuperscript{24}. Suddenly everything has become vicious\textsuperscript{25}.

\textsuperscript{20}Ibid.
\textsuperscript{21}Times of India 19\textsuperscript{th} April 2013
\textsuperscript{22}Times Of India, 20\textsuperscript{th} April 2013
\textsuperscript{23}Ibid.
\textsuperscript{24}Ibid.
\textsuperscript{25}Ibid.
In short we can say that fraud could have been prevented if the government took notice and take proper action. But the state government did not take any action even SEBI has directed it. As the SEBI was also aware of its limitation that chit fund are regulated by state government. Moreover the investors were also negligent as they didn’t inquire about the affair of the company. Even in 2009 SEBI has issued notice to Sharada Group for not complying with law as not issuing prospectus and not obtaining permission before issuing securities Investors didn’t pay attention to this fact. Moreover the investors should understand everything that brights is not gold. No one take notice of SEBI warning till confessional letter by Sen. Now he has fled. No one knows where he is.

Whatever be the scam- whether it be Harshad Mehta, Satyam Fraud, Sahara Estate Fraud of Shardha Chit fund fraud. Every time it has affected the whole nation. Fraud is like a cancer which today has reached at alarming portion. Now the question which arises is that when we have too many laws then why these corporate frauds.

The reason behind is that the law enforcing system is weak as regulators in most of the cases were negligent. They didn’t take any timely action. They only react when the fraud was committed. Moreover in each of cases the accused was not convicted. In Harshad Mehta case he was died whereas in C.R. Bhansali he was absconded, Ketan Parekh fraud is pending still in the court, in Satyam Fraud Raju Ramlinga the court has directed the accused not to deal in security market for 10 year. All the accused know that the case will be pending for many years and in last they may be acquitted on lack of evidence and most important the punishment provided is not stringent.