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**CORPORATE FRAUDS: ISSUES AND REGULATIONS**- Prakash Choudhary & Muskan Chhabra<sup>1</sup>**1. Abstract**

Due to the advancement of technology and industrial growth, the world has become one global village. This advancement has created various new forms of crimes one such is 'corporate frauds'. Corporate frauds have become inevitable and emerged as the biggest threats to the company. Corporate frauds are growing at an alarming rate around the globe. They have series of consequences attached to it. It not only destroys the reputation of the company and its board of directors but also hampers the confidence of investors and results in the destruction of their wealth. Corporate frauds have a huge impact on the economy of the country. It is responsible for the huge economic loss suffered by the country. The Government of India has enacted various legislations to curb and prevent corporate and financial scams such as the Companies Act, 2013, the SEBI Act, 1992 etc. The companies should also lay down strict processes, corporate governance practices and also make reforms in their recruitment process to make sure that the right people are hired.

Keywords: Corporate frauds, financial scams, economy, governance, legislations.

**2. Introduction:**

The whole world has been a victim of corporate frauds in recent times. Due to persistent increase in corporate sector, the frauds in the sector are also on the rise. Not only India but these financial scams and frauds have been prevalent around the globe. From financial scams like Enron, Sahara to Harshad Mehta scam, it looks like these corporate frauds have rotten the whole world. Generally, these corporate frauds cause severe consequences for the stakeholders, investors and general public. When we talk about the effect of corporate frauds, we only think of the loss of stakeholders and investors but what we forget is our economy relies significantly on the corporate sector and the rise in these corporate frauds effect the Indian economy. In

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India, these frauds are very consistent and there are some statutes which hold strict punishments for these frauds. One such statute is the Companies Act, 2013 which provides punishment for corporate frauds. There are enough rules and regulations pertaining to the corporate frauds but the problem lies in the implementations of these provisions.

### 3. Concept Of Corporate Frauds In India:

There are a lot of dimensions when we talk about financial scams but the most prevalent and which needs the attention in today's time is 'corporate fraud'. 'Fraud' has not been defined anywhere in the statutes but it basically means any harm done to the person for unfair advantage. It involves mala-fide intention. Corporate frauds are the most significant and have devastating consequences on the stakeholders, public and investors of the company. Corporate fraud means the fraud which happens within the company or any organisation.<sup>2</sup> It means any fraud done against any business corporation. Any financial gain of the fraudster which leads to the financial loss of the investors, stakeholders and public is a corporate fraud. In order to get unfair advantage of the company, the fraudster manipulates the business of the company. This often involves illegal means. Corporate frauds are considered as a part of White collar crimes. White collar means the crime committed by a person of high social status in the course of his occupation.

These financial scams are on rise in India and it has severe consequences for the Indian economy. The basic factors which are responsible for the rise of financial scams in India are: growth of technology, lack of ethical behaviour in employees and poor management.

### 4. Kinds Of Corporate Frauds:

There are various categories into which corporate frauds are further divided. These are as follows:

#### *a) Misappropriation of assets:*

It is a kind of crime when someone steals or misuses the assets of the company for their own advantage. This can be done by the employee or director or anyone who has been entrusted with the assets of the company. In other words, it is the theft or unfair use of the assets of the company, leading the company into loss. It can be done in various ways such

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<sup>2</sup> Ana Paula Paulino da Costa and Thomaz Wood Jr. on 'Corporate Fraud', available at [http://www.scielo.br/scielo.php?script=sci\\_arttext&pid=S0034-75902012000400008](http://www.scielo.br/scielo.php?script=sci_arttext&pid=S0034-75902012000400008).

as in cash, in cheques etc.

**b) Insider Trading:**

There are various things and information which is confidential for any company. The information about the company's stocks and securities is one of them. Insider trading is a type of crime wherein one trades with the company's stocks and securities in order to gain advantage. Most of the countries have prohibited taking advantage of such information for the sake of their security laws. Insider trading has devastating repercussions.

**c) Bribery and Corruption:**

Bribery and corruption are the most common types of white collar crimes. These include every illegal activity which influences the official/legal act. Bribery is a narrow concept, it means giving, receiving or offering anything which has a direct influence on the happening of an official act. When we talk about corruption it is a broader concept than bribery, it includes any dishonest activity done by someone entrusted with a position of authority for one's own gain. It means taking illicit benefit of their position for their private gain.

**d) Corporate Espionage:**

Corporate espionage is a crime when one company obtains confidential information about another competitive company in order to get financially benefitted by it. This activity is known as corporate espionage and it is on rise because of the competition among the companies. The company indulge itself to obtain confidential information about the rival company.

**e) Fraud Financial Statement:**

Fraud financial statement means manipulation of the financial statements of the company. It includes misrepresentation of the financial statements, overstating or understating the revenue of the company. These types of activities can cause serious damage to the company.

## 5. Famous Corporate Frauds:

Corporate frauds are on rise around the globe. Twenty first century saw the rise of corporate sector and the frauds attached to it. There are some famous corporate frauds cases which are stated below:

(a) In India

- **Harshad Mehta Scam, 1992:**

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When we talk about corporate fraud in India, the Harshad Mehta case is the first thing which the country remember. This scam caught eyes of millions of people in 1992 when the Stock market of India was crashed and Harshad Mehta was held responsible. Harshad Mehta was the architect of the Bull Run in India. The man was responsible for the siphoning of money from the Indian Banking system. He was responsible for the transfer of Rs. 4000 Crores from the banks to the stock brokers. This was one of the biggest financial scam India has ever witnessed.

- ***Saradha Group Chit Fund Scam:***

The Ponzi scheme was started by Saradha Group in collected money from investors by issuing redeemable bonds and secured debentures and promising incredibly high profits from reasonable investments. Local agents were hired throughout the State of West Bengal and given huge cash payouts from investor deposits to expand quickly, eventually forming a conglomerate of more than 200 companies. To keep ahead of regulatory bodies, the group used a nexus of companies to launder money.<sup>3</sup> Later in 2013, the group suffered the loss of 200-300 billion to a huge amount of depositors. The group collapsed and was also barred from SEBI from the security market and was asked to wind up these schemes and refund the money to the depositors.

- ***Satyam Case:***

Satyam case was the biggest corporate fraud in the history of India. It involved the largest IT Company of India i.e. Satyam Computer Services limited. This was a case of poor management and negligence on the part of directors and auditors of the company. This was considered as the biggest scam because the investors of the company suffered a loss of 8000 crores. Ramalinga Raju was convicted with the rigorous imprisonment of seven years and was asked by the court to pay the fine of Rs. 5 crore. He confessed before the court that he manipulated the account books of the company for several years. In order to please the investors and to meet their expectations, he overstated the income of the company for several years.

(b) In abroad

- ***Enron Scam:***

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<sup>3</sup> Dr. Mini Amit Arrawatia and Mr. Vikram Pande: 'A study of ponzi scheme with reference to Sharada scam', International Journal of Science, Technology and Management', Vol. 5 Issue 2, 2016, available at [http://www.ijstm.com/images/short\\_pdf/1455286111\\_558Y.pdf](http://www.ijstm.com/images/short_pdf/1455286111_558Y.pdf).



Enron Scam was the biggest corporate scam in the history of United States of America. It happened in the year 2001, when the corporate sector of the USA suffered huge loss. The Enron was in the good books of corporate analysts, corporate observers etc. until this scam. Several executives of the Enron went through the court process and most of them were sentenced and sent to the jail. They were charged of series of offences such as money laundering, insider trading, manipulation of financial statements of the company etc. This scam laid down the enactment of several new laws and regulations by the US government.

- ***WorldCom Scandal:***

This was also one of the biggest corporate scam in the United States of America. The CEO of the company was charged with the series of offences such as overstating the assets of the company, fraud in financial accounts etc.<sup>4</sup>

## **6. Provisions Related To Regulation Of Corporate Frauds In India:**

There are few Indian Statutes which helps in preventing and curbing the corporate frauds. These are as follows:

- i. Indian Contract Act, 1872
- ii. Indian Penal Code, 1860
- iii. Prevention of Money Laundering Act, 2002
- iv. Prevention of Corruption Act, 1988
- v. Companies Act, 2013
- vi. SEBI Act, 1992

- ***Prevention of Money Laundering Act, 2002:*** The economic crimes and frauds have been increasing rapidly due to the practice of money laundering. This act prevents such practices. Money laundering means and includes the process of turning the black money to white money.
- ***Prevention of Corruption Act, 1988:*** The issue of corruption has affected our whole nation. Corruption has been deeply rooted in India and emerged as the biggest risk to the society. It means when any person in authority misuse their power for their personal gain. This act consolidated various legislations such as the Indian Penal Code, Code of Criminal Procedure and the Criminal Act, 1952.

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<sup>4</sup> Francis Denteh: 'Enron: Fraud Detection Timeliness', available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1920747](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1920747).

- *Companies Act, 2013*: Section 447 of the Companies Act, 2013 talks about the same: “Any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.” *National Company Law Tribunal* is a quasi-judicial body which adjudicates the dispute arising under the Companies Act, 2013.

- Some of the corporate frauds involve security frauds. Security frauds are the frauds which include the manipulation of stock prices, insider trading, violating the rules of security regulations. These frauds can be done the employees, director of the company. Certain provisions under *SEBI Act, 1992* empower the Stock and Exchange Board of India (SEBI) to regulate the security market and also to take measures against the unfair trade practices of India.

## 7. Conclusion:

As the rise of the corporate sector, there is also a rise of corporate frauds around the globe. As discussed above there are various legislations and regulations which are working to curb the menace of corporate frauds. But, the problem lies in the implementations of such legislations. However, to conclude the article following are some suggestions which can be proved helpful for preventing these frauds:

- Whistle bowler policy can be useful against the corporate frauds.
- Empower SEBI with more powers.
- The companies should make stringent policies and reform their recruitment process so that the people with integrity are hired to the company.
- Employees should be made aware of the areas which are likely to be exposed to frauds and also to ensure that these frauds are investigated in time.