Corporate Fraud in India – Sahara and Saradha-An Analysis of Impact on Stakeholders

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Background

Since 2009, when the Sahara Group 's activities first came under the radar of SEBI leading up to the arrest of Sahara India Pariwar founder Subrata Roy in 2014, both parties have been engaged in an aggressive regulatory conflict. SEBI alleged that Sahara India Real Estate Corp Ltd (SIRECL) and Sahara Housing Investment Corp Ltd (SHICL), which issued Optional Fully Convertible Debentures (OFCD), illegally collected investor money. Meanwhile, Sahara denied SEBI had any jurisdiction in the matter. SEBI went on to order Sahara to issue a full refund to its investors, which was challenged by Sahara before the Securities Appellate Tribunal (SAT). When the SAT upheld SEBI's order, Sahara moved to the Supreme Court in August 2012, which ordered Sahara to refund investor's money by depositing it with SEBI. Sahara then declared that most of the US $3.9 billion had already been repaid to investors, saves for a paltry US $840 million, which it handed over to SEBI. This was disputed by SEBI, which claimed that the details of the investors who were refunded had not been provided. When Sahara failed to deposit the remaining money with SEBI and Subrata Roy skipped his hearing, the Supreme Court of India issued an arrest warrant for the Sahara chief in February 2014. Amid rumors of black money laundering and the misuse of political connections, Sahara vehemently denied all charges and continued to defy SEBI. The regulator persevered through what the Supreme Court 3 referred to as the ―ridiculous game of cat and mouse‖ and finally managed to pin down Sahara chief Subrata Roy in 2014. In this rare victory, SEBI not only brought Sahara to justice, but also made an excellent case for why the regulator, and others like it, require greater autonomy and penalizing powers.

Impact on Investors

Sahara scam was a big shock for the regulators of Financial Activities in India. It imposed many questions about compliance of regulatory procedures to be followed at the time of issuance of financial instruments by companies, end use of money and fixing the timelines for refund to the Investors. SEBI has been genuine in requesting investors for claiming the refunds, but due to lack of authenticity of Investor data base, SEBI has been able to process only 100 crore out of 14,487 crore received from Sahara Group. Even after the involvement of Supreme Court and Enforcement Directorate, the Investor's Rights Protection has remained questioned.

Saradha 'Chit Fund'

In another Case, Saradha 'Chit Fund' Ponzi scheme India has been flooded with various Ponzi schemes that take advantage of unsuspecting investors looking for alternate banking options. Lacking access to formal banks, low-income Indians often rely on informal banking. These informal banks invariably consist of money lenders who charge interest at inflated rates and were soon replaced by more sophisticated methods of conning people through disguised Ponzi schemes. Fundraising is done through legal activities such as collective investment schemes, nonconvertible debentures and preference shares, as well as illegally through hoax financial instruments such as fictitious ventures in construction and tourism. The rapid spread of Ponzi schemes, especially in North India, has various causes, not the least of which include the lack of awareness about banking norms, steadily falling interest rates, lack of legal action against such activities, and the security of political patronage. The Ponzi scheme run by Saradha Group collected

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money from investors by issuing redeemable bonds and secured debentures and promising incredulously 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. This syndicate was used to launder money and confuse regulators like SEBI. In April 2013, the scheme collapsed completely causing a loss of approximately US $5 billion and bankrupting many of its low-income investors. SEBI first detected something suspicious in the group's activities in 2009. It challenged Saradha because the company had not complied with the Indian Companies Act, which requires any company raising money from more than 50 investors to have a formal prospectus, and categorical permission from SEBI, the market regulator. The Saradha Group sought to evade prosecution by expanding the number of companies, thus creating a convoluted web of interconnected players. This created innumerable complications for SEBI, which labored to investigate Saradha in spite of them. In 2012, Saradha decided to switch it up by resorting to different fundraising activities, such as collective investment schemes (CIS) that were disguised as tourism packages, real estate projects, and the like. Many investors were duped into investing in what they thought was a chit fund. This, too, was an attempt to get SEBI off its back, as chit funds fall under the jurisdiction of the state government, not SEBI. However, SEBI managed to identify the group was not, in fact, raising capital through a chit fund scheme and ordered Saradha to immediately stop its activities until cleared by SEBI. SEBI had previously warned the state government of West Bengal about Saradha Group's hoax chit fund activities in 2011 but to no avail. Both the government as well as Saradha generally ignored SEBI until the company finally went bust in 2013. After the scandal broke, an inquiry commission investigated the group, and a relief fund of approximately US $90 million protected low-income investors. In 2014, the Supreme Court transferred all investigations in the Saradha case to the Central Bureau of Investigation (CBI) amid allegations of political interference in the state-ordered investigation.

Impact on Investors:

Impact of Saradha 'Chit Fund' was majorly seen in West Bengal, where in over 1.7 million of depositors were affected and 200-300 Billion were involved in the fraud. Though many political personalities were summoned and even officials of SBI are being summoned till date by CBI, the scam clearly indicates the irrecoverable financial loss of rural and low income population of country.

Sahara crisis victims: It's Employees

The dispute of Sahara and SEBI hit badly the job and salaries of the group of employees. The group operates more than 5,000 establishments across India with the employee strength of around 1.4 million full-time and part-time employees, including permanent staff at its various companies, permanent agents who get regular incentive payments besides a large number of part-time agents. The employees at all level in corporate offices faced the salary and other payment delay. The group faced heavy liquidity crunch resulting into many problems like meeting the salary, statutory and other operating obligations/expenses in doing business. Even an innovative idea was floated for collection of at least Rs Rs 1 lakh each from Sahara employees and “well-wishers” to accumulate at least 5,000 crore and secure Subrata Roy's from Jail.

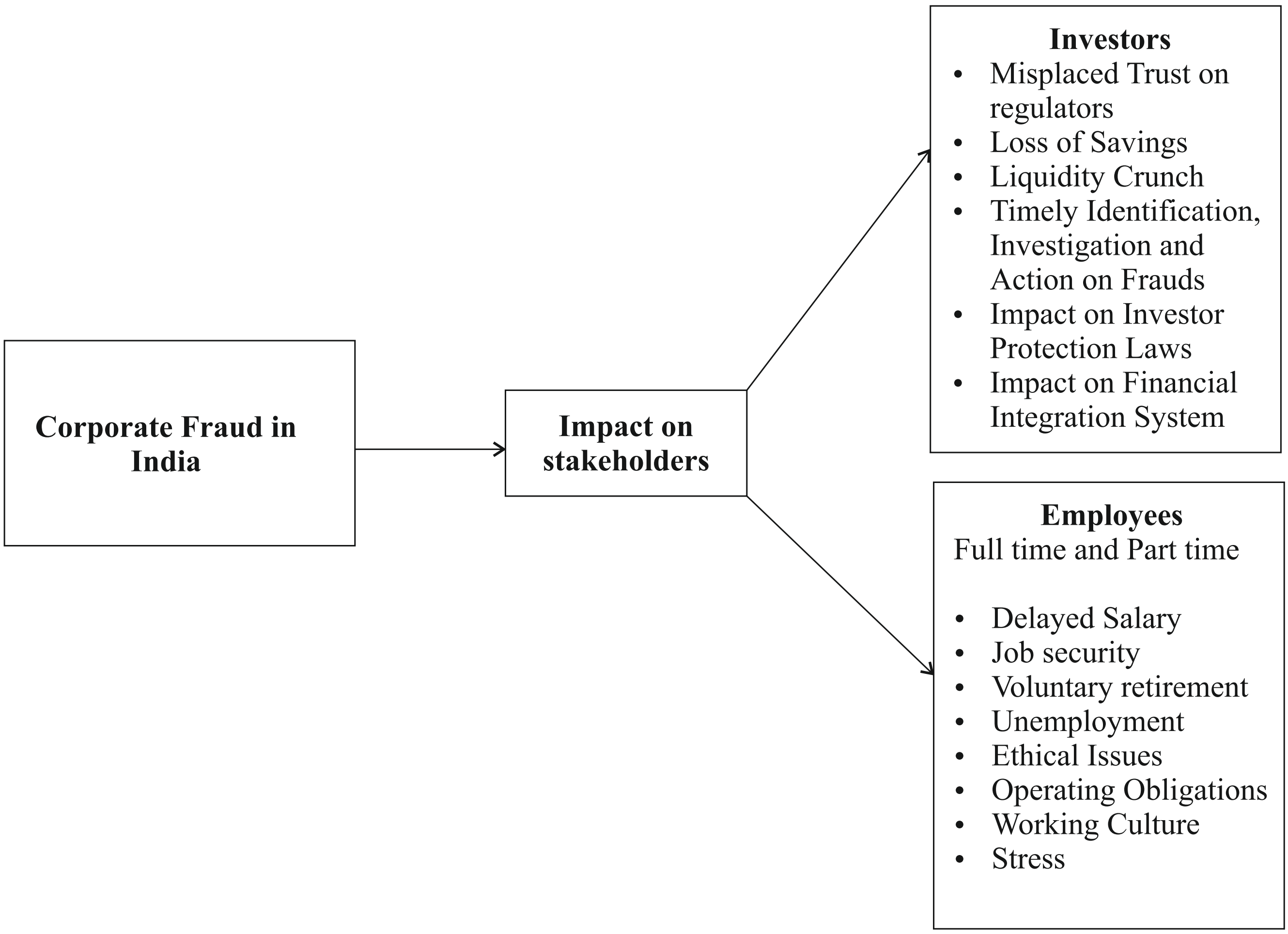
The contribution “appeal” was made through a page letter signed by director of this society and “associates” of the group and asked employees and well-wishers to contribute 1 lakh, 2 lakh or even more as per their wish and capacity. Since Sahara hasn't been able to deposit the Rs. 24,000 Cr amount with SEBI, the Supreme Court has asked Sahara India to submit a bank guarantee for Rs. 20,000 crore before 2014, October 28th which is the date for the next hearing of the case. SEBI had earlier rejected Sahara's offer to secure the difference (between Rs 5,200 and 24,000) through immovable property entrusted with a bank trustee. Sahara insiders claim there has been a significant drop in the number of employees and agents associated with companies because of unpaid salary and commissions. Some also left obtaining VRS.

With about 600,000 agents, about 2.4 million people could arguably be said to have been depending on Sahara for their livelihood (assuming an average four-person family). In a country like India where more than 250 million people live in abject poverty, unemployment and corruption, the rising financial scams should definitely bother us. The ramification of such scams is faced by all stakeholders of the organization.

Ethical consequences

What we often forget to notice is the serious ethical considerations and significant implication which it brings in the life of a common man. Such frauds tarnish the culture of the society and corporate. People find it difficult to trust companies; keep spending their time and effort in search of what suits them best. Clearly, corporate fraud has deep financial ramifications for all of us, even if we don't see them immediately. So yes, we should care. However, should financial aspects be the only reason we care? When the Ponzi scheme collapsed, the poorer population of West Bengal bore the worst brunt. Many were bankrupted, and a great number resorted to suicide.

Model: Impact of Corporate Fraud on Stakeholders



Solution

Law for protecting whistleblowers is vital. Employees should be assured safety and job security so that they are more willing to volunteer to share information and maintain transparency in Indian Corporates. Better execution of Prevention of Money Laundering Act (PMLA) and need of one single regulator for entire collective investment schemes were identified. Also Aadhar based financial integration has plugged in above discussed frauds to a great extent. Compliance of Companies Act 2013, Foreign Exchange Management Act (FEMA) and Income Tax Act, 1961 is also required.

Questions:

1. **Why did SEBI ask Sahara to refund the money?**
2. **Which regulatory procedures did Sahara not comply with?**
3. **What lessons are learnt from Sahara case?**
4. **How the case impacted the employees?**
5. **How the case impacted the Investors?**

Case Study on
PI Foods Ltd – Managing Sales and Distribution

Dr. Arpita Srivastava*, Vikram Kumar Sharma**

Ramesh Kulkarni, Regional Sales Manager, Western Region, of PI Foods was discussing with his Area Sales Managers about the complaints of shortage of supplies by some of the Distributors and Non-Receipts of company's products by C and D class retail outlets. These complaints were received by Ramesh directly from the distributors and the retail outlets. Ramesh expressed his total dissatisfaction that none of the three Area Sales Managers had informed him about these problems earlier.

PI Foods' product-mix consisted of baby foods, dairy products like milk powder and ghee, chocolates and confectionary and beverages.

For household and individual consumer, the company's distribution channel consisted of distributors and retailers, and for business (or institutional) customers, the company had distributors and its own sales workforce, as shown in the *Exhibit 1*.

Each distributor's salesperson was given a geographic area (or a Sales Territory) to cover all types (or classes) of retail outlets located in his territory, as per the norms of frequency of visits shown in *Exhibit 2*.

The time taken for A or 'Super A' retailers was much more and also their sales potential was high. Hence, the natural behaviour of the salespeople was to achieve the weekly and monthly sales targets by spending more time with Super A, A and B Class retailers. Only if the time permitted they visited C and D class retailers, and therefore, sometimes these retailers were not visited, as per the standard norms shown in Exhibit 2.

Ramesh told the area sales managers that he came to know from C and D class retailers that the distributors' salesperson did not visit these outlets on a regular basis. He further said that not only it affected the company's sales and leadership position in the market, but also the satisfaction levels of retailers. Ramesh asked the sales managers what they were doing about these problems. The area sales managers responded that regarding irregular visits to distributors' salesperson, they would revert after talking to their sales officers. However, regarding shortage of supplies to the distributors, the main reasons were incorrect sales forecasting by distributors, factory production constraints and misallocation of dispatches from warehouses to distributors due to lack of information on the differences in the estimated or forecasted sales figures and the factory production figures. The area sales managers said they needed some time to talk to various persons before making any suggestions to solve the problems. Ramesh agreed to give one week's time to the area sales managers and said he could not give more time, as the issues involved were important and were to be resolved on priority.

Exhibit 1: Distribution Channels

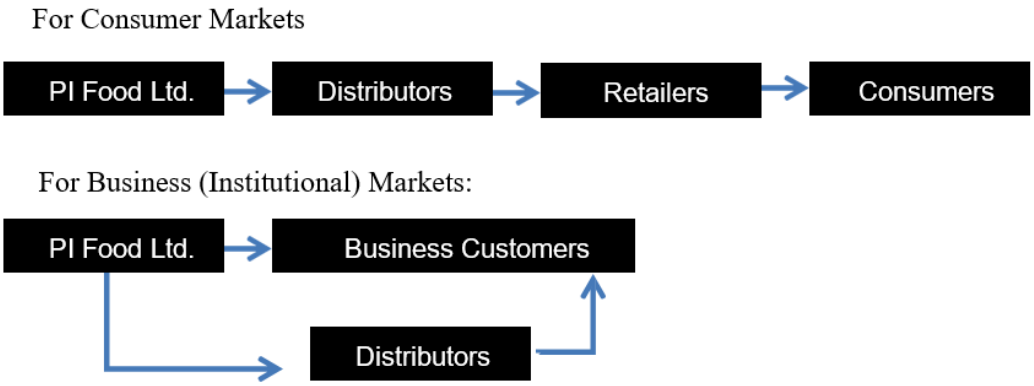


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Exhibit 2: Norms of Frequency of Visits to Retail Outlet Types

Type/Class of Outlets (Retailers)	**Sales Potential (Rs. Per Month)**	**Frequency of Visits per week (Numbers)**
D Class	Pan shop (Less than 1000)	Once in 2/3 weeks
C Class	Small Shop (1000 – 2500)	Once in 2 weeks
B Class	Midsize Shop (2500 – 7500)	1
A Class	Large Size Shop (more than 7500)	1
Super 'A'	Super Markets, Chain Stores (more than 15000)	2 or 3

Questions:

1. If you were the area sales manager what would be your suggested plan of action to resolve the problems?
2. Do you agree with Ramesh that issues involved were important and should be resolved on priority? Give reasons.