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Governance and Ethical Issues in Sahara & Kingfisher

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Abstract:

This paper revolves around the fundamental theme of corporate governance in private sectors in India in light of the recent scams of Sahara Group and Kingfisher. It elucidates how such scams in private companies also impacts the shareholders of the companies concerned, apart from the scores of employees, customers and the general public. In light of the case, the paper traces how the need of the hour has called for incorporation of corporate governance in the private sector with scores of public investors' interest indirectly vested in the private sector market. In particular, the paper talks about the various governance as well as ethical issues revolving around the two major corporates of India which led to their collapse and destruction of confidence of large number of investors. The political connections of the Chairpersons of the two corporates have also been highlighted to grab the attention towards their reckless spending on the political affairs at the sake of general investors and the common people. The cases analyzed here are significant in terms of the Rupees misappropriated and in terms of the number of people involved or damaged as a result of the frauds.

Keywords: Corporate Governance, Sahara Group, SIRECL, SHICL, Kingfisher

1. Introduction

In this paper, we examine the two cases in order to evaluate, in some detail and from various perspectives, what can occur when management misrepresentations in the financial accounts lead to adverse social, political and economic consequences. The costs of frauds within an organization can be costly to shareholders, to employees and to sometimes the public at large. The cases analyzed here are, for the most part, well known: Sahara Group's Money Laundering and Kingfisher Airlines' poor governance. They are also significant in terms of the Rupees misappropriated and in terms of the number of people involved or damaged as a result of the frauds. With this paper, an attempt has been made to bring a fresh perspective to the stories around these corporate failures by examining the fraudulent activities from the various perspectives such as role of auditors, political nexus of chairpersons, 'independence' in independent directors and many more. The paper begins by providing the background of the two cases, its origins and rise, and then what went wrong and how these scams are nothing but the result of poor governance and a lack of ethical perspective.

2. Sahara Group

Sahara group success story began in 1978 with Rs. 2000 in capital, a *Lambretta* scooter, a table, two chairs, a clerk and a duty boy. Starting on a modest scale the company has passed through a long way to become a leader in Indian entrepreneurship. Roy calls his corporate philosophy "collective materialism", one that advocates collective growth for collective sharing and caring. Sahara's employees and agents have never formed a union. The group does not declare dividend and 40% of the profit is spent on welfare of workers – called *kartavyayogi*; 35% goes into the company's net owned funds and rest is spent on social work. Most of the Sahara's clients are small shopkeepers and daily wage earners, who deposit Rs 10 to Rs100 every day. The agent typically a relative is the key to deposit mobilization.

2.1. The Case of Money Laundering

Way back on August 31, 2012, the Supreme Court had asked Sahara group companies Sahara Housing Investment Corporation Ltd (SHICL) and Sahara Real Estate Corporation Ltd (SIRECL) to hand over Rs 24,029.73 crore to SEBI, with 15 per cent interest per annum from the date of receipt of the amount till the date of repayment, within a period of three months. SEBI was ordered to return the money after ascertaining the genuineness of each of the 2.96 crore investors and deposit the balance in the government revenue account.

- Sahara group only paid the first tranche of Rs 5,120 crore and defaulted in giving back the remaining amount. But they claimed in December 2012 that they had already paid off the investors Rs 22,885 crore. That is repayment within 4 months—in cash.
- The source of these 22885 crore—all cash—is a mystery that they wouldn't disclose even to the Supreme Court.
- If we add the accumulated interest, the total repayment from SAHARA would be 37000 crores.

- Earlier, they had claimed the deposits with them as private placement from 3.07 crores of friends, families, associates and employees! They first claimed that no general public was involved at all.
- Even before the SEBI case, when they first came under the RBI scanner, Sahara companies claimed to be dealing with small amounts deposited by millions of depositors. When the RBI revised the rules for Residual Non Banking Companies (RNBCs) and sought to control its para-banking activities, Sahara claimed to have repaid Rs 73000 crore, four years before maturity, and announced the same through advertisements. SEBI came into the picture when a Sahara group company filed a prospectus to go for a public issue of shares and the details included deposits raised by two other Sahara Companies.
- After the Supreme Court passed the order, Subrata Roy Sahara, in a full page advertisement, challenged SEBI for a national TV debate, to settle the matter!
- When the SEBI order was passed, depository accounts in India totaled 15 million. The largest company in India today has 4 million investors. Sahara claimed to have 30.7 million!
- The latest advertisement by Sahara talks about 80 million investors while India has about 250 million households. A third of India is below poverty line which means every second household in India would be a Sahara investor.
- Based on investors details submitted by Sahara, SEBI sent out 21000 letters:
- Only 280 responded.
- 7000 letters were returned with addressee not found.
- Fake Investors: The list of investors submitted to SEBI, on a quick examination, included:
 - 5984 Kalawatis
 - 55 Kalawatis at the same address
 - A Kalawati having the same address as a Mairunnissa, another investor
 - A Kalawati being paid back on the same day multiple times
 - 1433 Anirudh Singhs, all of them S/ O Hukum Singh
 - One depositor's name was Haridwar.
 - An address was Jaipur, Nagpur, Maharashtra.
 - Another address was Aurangabad, Lucknow, UP.
 - Fake accounts & addresses: There are numerous instances of:
 - one person having multiple accounts
 - one account having multiple beneficiaries
 - one person with multiple addresses
 - One addresses having multiple investors.
 - People whose claimed dues spread over multiple accounts running into crores.
 - Many depositors addresses are untraceable,
 - There were cases having addresses like national highways, and just names of villages with no specific house number etc.
 - Fake claims: In SC, Saharas deposited a title deed of a 106 acre plot in Versova and claimed its worth at Rs.19300 Crores!! SEBI says it is not worth a penny, because it is in a mangrove and in a no construction zone.
 - Sahara claims to employ 12 lakh employees. Applying the minimum Act Including PF, ESI, Bonus etc, the cost is 12500 per month. If i were to take different scales, the average would be 25000/month. That would be 36,000 Crores p.a of salaries alone! And the PF dues on such salaries would be about 5000 crores/annum. EPFO did ask for the details as they scarcely match with their records and Sahara's go to Lucknow High Court and start another 'merry go round'.
 - In an advertisement, they even declared a 60% increment across the board.

2.2. *There are various governance and ethical issues involved in the collapse which can be discussed as follows*

2.2.1. Unethical conduct

Sahara Group, or specifically its two companies SIRECL & SHICL have manipulated its investors, issued bonds without following the rules, created multiples of fake investors with fake addresses, made 'public' issues by way of private placement; collected approximately 17.65 crores rupees via so called 'private issue' and carried out various transactions in securities in a manner detrimental to the interests of investors and the securities market.

2.2.2. Fraud

Sahara group defrauded numerous middle-income investors by playing with their emotions and taking away their hard-earned monies and savings. Investors like Shankar, Krishnamurthy invested in SHICL's housing project for additional four years after the initial deadline to complete the flat, with the hope to make their dream of home a reality. They were not even sure whether the Sahara has land to develop the project. According to Sahara, "more than 50 percent of the investors are downtrodden people who never go to banks and banks never reach them. There are a large number of small investors who don't even have their own houses or dwellings. The average amount invested is Rs 8,000". Sahara has played with the consciousness of these people by promising unusually high returns. There are no know-your-customer (KYC) norms followed and nor is there a bank trail.

2.2.3. Violation of Law

Section 60B (1) casts no obligation to issue information memorandum. However, Sahara companies chose to issue it and invited public demand for OFCDs. After filling IM, Sahara ought to have filed a final prospectus prior to opening of subscription lists. Also, Sahara states the issue of OFCDs as private placement but its action/facts were contrary to that stand as such securities were offered to more than 50 persons and it is deemed to be a public offer. Moreover, the documents produced to the court do not show the relationship of the company with the investors. In addition, Sahara's had not executed any Debenture Trust Deed for their OFCDs, not appointed any Debenture Trustee and not created any Debenture Redemption Reserve, which would amount to violation of Sections 117A, 117B and 117C of the Companies Act.

2.2.4. Lack of 'independence' in directors

Roy's wife Swapna and his brother, Joy Broto Roy, were there in the Board of directors while Roy's sons Sushanto and Seemanto, run the property and media businesses respectively. OP Srivastava – considered a loyalist having been with Roy when the business first started, is another deputy managing worker in the board.

2.2.5. Inadequate role of Regulator

All these years, no detailed inquiry has been launched into understanding the money trail in Sahara's case, reflecting poorly on the regulators. At times, it would appear that because Sahara was dealing with depositors, the RBI would be in charge. But the complex web of unlisted companies and cross-holdings has made it harder to pin point. In 2010, Sahara had claimed that the Union corporate affairs ministry had exclusive jurisdiction to probe it. Sahara group took the regulatory arbitrage advantage by claiming that it comes under the jurisdiction of MCA and conducting all the activities and transactions as a listed company, violating the rules claiming it to be "unlisted" and moved from one unregulated jurisdiction to another. Unless regulatory arbitrage was reduced, there would be a tendency to avail of gaps and therefore to plug regulatory gaps, clear rules and better coordination among regulators was required.

2.2.6. Lack of Transparency

The lack of transparency over business affairs has been one factor leading to Roy's reputation. It is notable that he is involved in sectors which have traditionally poor governance reputations. His business affairs were opaque; he never disclosed his balance sheets and annual reports to anyone, keeping it 'confidential'. The company even showed hesitation in producing the relevant documents and information on demand by SEBI by stating that SEBI has no jurisdiction to rule over its matters

2.2.7. Political connections of Subrota Roy

Subrota Roy is known to be an industrialist whose core business is laundering money for top politicians, even the underworld. Roy had friends across the political gamut, but over the years, he came to be identified more with Mulayam Singh Yadav and his Samajwadi Party. He also had a connection with Gorakhpur based Vir Bahadur Singh, an author-politician from the Congress stable but his mysterious death in 1990 in Paris left him without any political support. He got connected with Mulayam Singh Yadav when Yadav was serving his first term as CM from 1989 to 1991 but the relationship grew stronger when Yadav became CM again in December 1993 with the help of Amar Singh. The Amar Singh and Subrota Roy duo added glamour to the simple and dull Samajwadi party. When Mulayam became the Defense Minister in the United Front government of 1996-98, the duo also helped him in navigating the whispering corridors of Delhi. Moreover, Sahara Airways and fleet of Roy's private planes were used to ferry top politicians from UP and other states many a times. The wedding reception of Akhilesh Yadav, son of Mulayam, was also hosted at Sahara Sheher in 1999. In 2012, when Akhilesh became the CM, a grand lunch part was hosted by Roy in the Sahara Sheher for the celebrations.

3. Kingfisher Airlines

Kingfisher is finding it difficult to reinvent itself. It is trying hard to be a phoenix but will it truly rises from the ashes or simply fade away is the real question. On May 9th 2005, Kingfisher Airlines' commercial operation was started. With a promising tag line 'Fly the Good Times' this new airline was able to have its main hub at Bangalore International Airport and secondary hubs at Shivaji International Airport (Mumbai) and Indira Gandhi International Airport (New Delhi). Kingfisher was launched as an all-economy, single-class configuration aircraft with food and entertainment systems. After about a year of operations, the airline suddenly shifted its focus to luxury. When an airline keeps changing its model and takes to random expansion, there is no time for the airline to stabilize. After Kingfisher's plunge into luxury came its next folly—a merger with Air Deccan, an airline formed by Captain G R Gopinath in 2003. The all-economy configuration of Air Deccan was rebranded and called Kingfisher Red, which continued to operate as its low-cost wing till recently. Kingfisher ended up spending Rs 550 crore on an airline that had losses of over Rs 550 crore. It is widely believed that Kingfisher merged itself with Air Deccan so that it could classify as an airline with five years of domestic flying in 2008, thus fulfilling requirements to fly international routes.

3.1. Accounting Fraud of Kingfisher

3.1.1. Debt Recast

Non-performing loans of Kingfisher Airlines were rechristened or repackaged into subordinated debt. During Financial Year 2010, Kingfisher defaulted in principal repayment of Rs. 2,031M (US\$ 45M) and overdue interest of Rs. 816M (US\$ 18M), for a total default of 2,847M (US\$ 63M). Between July 2010 and March 2011, the company defaulted on interest payments of Rs.

3,498M (US\$ 77M). Foregone principal repayments are undisclosed. Therefore, from the beginning of FY10 to the end of FY11, the airline defaulted on dues of at least Rs. 6,345M (US\$ 140M) to the financial institutions. Clearly, the loans given by the banks to Kingfisher are impaired and therefore under the pretext of a debt recast, the banks have converted some of these unpaid principal and interest amounts into cumulative convertible preferred shares {Rs. 7,550 million (US\$ 166M) of term loans converted into CCPS of 7.5%} and cumulatively redeemable preferred shares {Rs. 5,530 million (US\$ 122M) of term loans converted into CRPS of 8% with a maturity of 12 years}.

3.1.2. Auditors overruled by Management

The Auditors have had no say in the decision-making. The auditors have “qualified” reported financials of the company on multiple occasions, referencing accounting policy changes and expressing disagreement with management’s interpretation of Indian Accounting Standards. But their disagreements were overruled by the management. Therefore, the investors had neither reliable nor timely information on Kingfisher.

In its FY11 annual report, the auditors said, “*Attention of the members is invited to note 24 of schedule 19 regarding the financial statements of the Company having been prepared on a going concern basis, notwithstanding the fact that its net worth is completely eroded. The appropriateness of the said basis is inter-alia dependent on the Company’s ability to infuse requisite funds for meeting its obligations*”. Clearly the auditors were skeptical of the “going concern” credentials of Kingfisher.

3.1.3. Accounting Policies:

The management of Kingfisher Airlines treats their auditors with contempt and it is off-side Indian Accounting Standards, and from the following quote from its Annual Report of FY 2010 & FY 2011, it is clearly proved that the revised accounting treatments were not in accordance with current accounting standards.

“Attention is invited to note 29 of schedule 21 regarding change in the method of accounting of costs incurred on major repairs and maintenance of engines of aircrafts taken on operating lease during the year aggregating to Rs.20,700.76 lacs (US\$ 45M) which have been included under fixed assets and amortized over the estimated useful life of the repairs.

Page 33, F10 Annual Report

“Attention is invited to note 27 of schedule 19 regarding method of accounting of costs incurred on major repairs and maintenance of engines of aircrafts taken on operating lease during the year aggregating to Rs.12, 256.85 lacs (US\$ 27M) {year ended March 31, 2010 Rs. 207, 00.76 lacs (US\$ 45M)} which have been included under fixed assets and amortized over the estimated useful life of the repairs.

Page 29, F11 Annual Report

3.1.4. Cost Capitalization

In FY10 and in FY11 the company decided to capitalize the expenditures associated with engine overhauls, rather than expensing those costs as a current period expense. The benefit of capitalizing costs is that both the EBITDAR and the EBITDA metric – dear to the company – are inflated and remain unaffected by the subsequent increase in amortization that flows below the EBITDA/EBITDAR line. Moreover, in its FY10 and FY11 financial presentations, company has been flaunting improved EBITDA and EBITDAR to the investing community, without referencing the accounting policy change that boosted both metrics by Rs. 2,070M (US\$ 46M) in F10 and Rs. 1,225M (US\$ 27M) in FY11.

3.1.5. Unreliable EBITDAR

EBITDAR measures operating results before taxes, interest, depreciation, loan amortization, and rents. In absence of the accounting policy change, for FY10 Kingfisher would have reported an EBITDAR of Rs. 1,910M (US\$ 42M) instead of Rs. 3,980M (US\$ 88M) lower by 52%, and for FY11, Rs. 10,015M (US\$ 220M) instead of Rs. 11,240M (US\$ 247M), lower by approximately 11%. Charges of Rs. 396M in FY11, and Rs. 3,576 M in FY10 incurred on account of early termination of aircraft lease contracts were also excluded from the reported EBITDAR by the company.

3.1.6. Misrepresentation & Lack of Transparency

Kingfisher’s disclosure is poor, accounting policies unreliable, balance sheet is in compulsion, free cash flows are absent, collateral provided to financial institutions by its holding company is insufficient and the actual liabilities on Kingfisher’s books are understated. Moreover, Kingfisher is already in arrears of Rs. 430M (US\$ 10M) on the CCPS and CRPS issued as part of the debt recast in March 2011, excluding the Rs. 12,863M (US\$ 283M) of guarantees/letters of credit given by banks on behalf of the airline that it does not acknowledge as debt.

3.1.7. Employees Money at Stake

As per the FY11 Annual Report, Kingfisher was also in default of the dues owed on behalf of its employees to regulatory authorities, which it doesn’t count as debt. As per the auditors of Kingfisher, “*Undisputed amounts payable in respect of employees state insurance of Rs.0.75 lacs (US\$ 1,619), provident fund of Rs.43.80 lacs (US\$ 94,564), tax deducted at source of Rs. 42,297.52 lacs (US\$ 93M), service tax of Rs.1,047.76 lacs (US\$ 2.3M), professional tax of Rs.2.46 lacs (US\$ 5,412) (In all cases relating to the years 2008-09, 2009- 2010 and 2010 - 2011) and fringe benefit tax of Rs. 450.70 lacs (US\$ 1M) (balance of tax and interest for the financial year 2008-09) ...*”. The due dates for these amounts are as per respective statute3.

Clearly, the company is funding itself at the expense of its employees and the Indian exchequer, to which it owed tax deducted at source on behalf of its employees of Rs. 4,229M (US\$ 93M) as per the FY11 Annual Report.

3.1.8. Lack of Professional Management

There was a lack of or rather absence of professional management. Kingfisher was gifted to Mr. Sidhartha Mallya by his father on his birthday i.e. a Near Zero experience in running a company and the later CEOs appointed by Mr. Mallya couldn't bring any significant result too. His over indulgence in petty things like parties and Kingfisher Calendar also lead to inadequacies in his finances. IPL is also one of the reason for Kingfisher downfall because it is known that many of the money was diverted to IPL from Kingfisher airlines, resulting which they defaulted in Loans and recently became a NPA (non performing asset) to its leading bankers like SBI.

3.1.9. Failure of Risk Management

The failure of Kingfisher was the failure of risk management. The three strategic mistakes committed by Kingfisher are: Takeover of a Loss-making Air Deccan, led by Captain G. R. Gopinath.

Role of Vijay Mallya as an absentee landlord, i.e. being into several businesses of liquor, beer and airlines, he was not able to give his undivided attention to the Kingfisher and the airline had everything going for itself: great brand visibility, loyal customers and a wide network.

3.1.10. Political Connections of Vijay Mallya

Mallya's proximity to the powerful political class has also for long been a cause of complaint for his competitors. Be it NCP leader Sharad Pawar or former aviation minister Praful Patel, Mallya has been seen to be on pleasant terms with those who mattered. No reason has yet been forthcoming for the sudden transfer of former director general of civil aviation, Bharat Bhushan. Bhushan raised meaningful questions on the operations and safety of keeping Kingfisher up in the air.

4. Conclusion

Each case is unique. Sahara group is a story of two private companies whose directors, despite going public to raise funds, continued to treat its finances as a personal piggy bank for its founding family. It is a clear case of money laundering with fake investors, fake addresses and dramatic violation of laws. It also tells the story of a market gone mad, placing perhaps unrealistic expectations on continued growth and profit-making that could not reasonably be met. Kingfisher Airlines scam informs us how company's wrong decision and excessive and illogical expansion affects not only its investors, but also society – its employees, customers, regulators and others. Despite distinctions, these two situations share some common features which may be informative to researchers, auditors and governing bodies. One might find a common string in some characteristics of the human condition, and perhaps those means and opportunities that expose its darker sides. These cases also tell a story of how seniors in industry are held – or not held- to account for public actions. It seems that, despite their different settings and industries, these cases share a combination of opportunities via, for instance, powerful positions on governing boards, pressures to perform sometimes unrealistic feats of enterprise, and a false confidence in their 'rightness' in performing fraudulent activities. They appear to paint a common picture of a lethal-to-the-public combination of opportunity and greed so damaging to those who come into contact with them. Also noted is a pattern in the nature of transactions that led to the largest and most damaging levels of fraud. The process of raising 'money' appears as a frequent element of this game, especially for Sahara group. Through the existence of compliant banks and lenders, with the support of complacent or powerless boards, or in particular through the use of intercompany relationships and financial gamesmanship we see the company and public defrauded on a massive scale. So if it is all so predictable, then why didn't the auditors discover and reveal these problems? We can observe a pattern here in which, at least in these cases, the auditors did not provide the quality of analysis that the public might have expected, either because they have no say or they are lured for the same. The reasons for such problems seem to range from a simple failure to identify the fraud to what appears to be failure to act upon their knowledge of it when it became known. In most cases, and given incomplete access to information, we cannot and will never be able to fully know the balance that may have occurred between the two, or where the primary fault may have lain. Nonetheless, there does seem to be some pattern: a failure to pick up the warning signals, a struggle to sort through convoluted equity structures and, sadly in some cases, less attention to 'independence' than should have occurred. There are lessons for many in this selection of corporate fraud disasters.

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