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Failing in corporate governance and warning signs of a corporate collapse

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Failing in Corporate Governance and Warning Signs of a Corporate Collapse

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Abstract

History of corporate world is fraught with manipulations and scams. These corporate frauds are widespread, costly, and multifaceted and adversely affect all stakeholders. Starting from the 'first well-documented' securities manipulation fraud, known as the 'Dutch Tulip Mania' in 1636 and 1637 in the Netherlands, to 'Glaxo China' in 2014, corporate frauds around the world, have rocked the corporate world resulting, either in new or revamping of the older governance structures, codes and guidelines. This paper aims to categorize prominent factors responsible for corporate collapses and that too of reputedly sound corporate giants during the period 1990-2014. Review and analyses of 55 cases from 16 countries identify USA as the country highest in corporate frauds with 53% of the cases going to its credit. In 83% of the corporate collapses, the Chief Executive Officers (CEOs) in collusion with 77% of the Chief Financial Officers (CFOs) have been held responsible. In 72 % of the cases, the main players have faced criminal penalties and were sentenced to jail, whereas 69% received monetary penalties. A number of factors including greed and over ambitiousness of the top executives and poor internal controls have found to be prominent causes of corporate collapses. All the corporations that collapsed, were corporate giants in their own fields, had strong market repute and rich annual reports. But all fell a prey to, either over ambitiousness or to greed of their top notch executives, who indulged in high risk ventures in order to expand. In major corporate scandals, stakeholders apparently were misled by sound annual reports, while the facts later on revealed presence of gross management misconduct, fraudulent financial reporting and auditing issues. The aggressive and speedy growth and expansion of any corporation, has been found to be a common warning sign that should be examined skeptically by any shareholder or investor before investing.

Keywords: corporate governance, governance theories, corporate scams, modi operandi, CG failings

1. Corporate Governance: An Introduction

UK 1991, the sheer abuse of power in the Maxwell case, cost £2.8 billion to the bankers and a loss of £530 million of pension funds to 16000 employees. Robert Maxwell, the founder, CEO & the chairman of Maxwell publishing group, over ambitious and feared

for his 'litigious' nature, wanted to be a media giant and took to court his rivals and financial analysts who did not approve of his business methods. Maxwell, misappropriated funds, pledged assets as security for additional loans, diverted shares and cash from one company to another under his control and pledged those shares as security for further loans to his own private companies. The fraud was discovered when Robert Maxwell was found dead in a sea, cause still unknown (Wearing, 2005).

USA 2001, Enron, an energy group, with its 30,000 employees all around the world and phenomenal speedy expansion was ranked as the top 7th company with $100 billion of revenues by *Fortune 500*. It was also ranked for seven years as '*Fortune's* most innovative' company and was predicted by analysts of being the number one most successful company by 2001. But, in that same year, the company filed for Chapter 11 bankruptcy, and admitted to financial reporting irregularities during 1997 to 2000 (Banks, 2004).

Netherland 2003, Ahold,aFood supplier and supermarket chain, turned out to be 'Europe's Enron. It was engaged in a rapid growth but high-risk strategy, faced fraud and other criminal charges for false business records and misreporting its financial health. The CEO and CFO received unconditional fines and suspended prison sentence. Italy 2004, Parmalat, a food group, went down when it was unable to pay a bond repayment of €150 million. Senior executives of the company faced false accounting charges, an Administrator was appointed, and its senior auditors got arrested.

Germany 2006, the CEO, the accounting officer and 300 Employees of Siemens, a telecommunication company Active in 190 countries, were found guilty of massive corruption for paying 1.3 billion Euros worth bribes to government officials and business partners. This greatest bribery scandal in German history ended in total damages of 1.6 billion Euros.

Japan 2011, the chairman, executives and the directors on Board of Olympus, a manufacturer of optical equipment, were involved in, what is known as the biggest fraud in the history of Japan, were sentenced and ordered to pay hefty fines.

China 2014, the head of operations of the GlaxoSmithKline (GSK) or Glaxo China, in May 2014, after 10 months of investigation, has been accused of "ordering employees to commit bribery on a widespread scale…… to win market share and agree higher prices." Four senior managers have so far been arrested and the bribe amount is allegedly £320m (Roland, 2014).

History of corporate world is fraught with manipulations and scams. These corporate frauds are widespread, costly, multifaceted and adversely affect all stakeholders (Alleyne and Elson, 2013), and cause ripples in the financial world. The series or waves of corporate scandals around the world have also been responsible for shaping up of the corporate legal framework that exists today. Development of the concept of a company, that of limited liability and shareholders, framing of companies' laws, formation of regulatory and monitoring authorities such as security exchange commissions, creation of the institution of auditors etc., are all counter measures developed as a consequence of one or the other wave of corporate scandals.

Table 1: Corporate Governance Perspectives

Year	Contributing /Researchers	Theories/ perspectives	Dimensions
1776	Adam Smith	Principal-agent relationship	Recognized problems due to separation ofownership and control which can easily result in directors not being careful with shareholders' money.
1932	Berleand Means	Foundations of Agency theory	Provided foundational text on corporate governance and worked on the consequences of separation of control from the ownership.
1976	Jensen and Meckling	Agency theory	Most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among various individuals,' such as shareholders, employees, and society at large.
1992	Donaldson and Davis	Stewardship theory	Managers are stewards of the corporations who protect and maximize shareholders' wealth through firm performance.
1997	Shleifer and Vishny	A financial economic perspective	Corporate governance deals with providing assurance of returns to the financers of a company.
1996	Tirole	A stake holder perspective	"The design of institutions that induce or force management to internalize the welfare of stakeholders."
2009	Tricker	A resource dependence perspective	The board is 'the lynch pin between a company and the resources it needs to achieve its objectives.

Source: Wearing, 2005; Tricker, 2012; Mallin, 2013

Corporate governance too was conceived to prevent and defeat fraudulent practices. It is an emerging and a globally debated phenomenon, and its development is based on different complex disciplines, including but not limited to finance, management accounting, law, and politics as also culture. It evolved with the development, growth and advancement of the economy as well as with the increasing complexities of the corporate ownership and other structural differences (Mallin, 2013). "Corporate governance is said to be a framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with all its all stakeholders (BusinessDictionary.com). Derived from Latin, 'governance' means 'to steer', usually associated with steering of a ship, which implies that, it is more about direction than control (Solomon and Solomon, 2004). Various perspectives have been explored and a number of theoretical frameworks have been developed to analyse corporate governance issues, but none is known to be exhaustive. Initiated by separation

problem between ownership and control in modern business models (Berle and Means, 1932), scholars have analyzed corporate governance using the Agency theory, based on accountability of investees to investors (Solomon and Solomon, 1999). Others have used alternate theories based on stakeholders', stewardship, political perspectives (Turnbull, 1997).

Financial, societal, social and resource dependence theories have also been used to entrap the notion of a firm's accountability, to not only the investors and shareholders, but also to all other stakeholders like the financiers, customers, management, employees, government, and the society or community (as discussed by Tricker,2012).

1.1Role of Corporate Frauds in Development of Corporate Governance

Starting from the 'first well-documented' securities manipulation fraud, known as the 'Dutch Tulip Mania' in 1636 and 1637 in the Netherlands, followed by the Mississippi Company Scandal of France in 1717 (Sarna,2010), the South Sea Bubble scandal of England in 1720, the failures of corporate giants such as WorldCom and Enron in the USA. in 2001, Parmalat in Italy during 2003 (Wearing, 2005), the Madoff scandal revealed in 2008 and numerous other such cases around the world, have rocked the corporate world resulting in either new or revamping of the older governance structures, codes and guidelines.

Table 2: Corporate Governance Definitions

Year	Authors	Definitions
1984	Tricker	“. . . the governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries”.
1992	The Cadbury Report, para2.5	"the whole system of controls, both financial and otherwise, by which a company is directed and controlled."
1993	Blair	“the whole set of legal, cultural and institutional arrangements that determine what public corporations can do, who controls them, how that control is exercised, and how the risks and return from the activities they undertake are allocated”
1995	Centre of European Policy Studies (CEPS)	“Corporate governance is the whole system of rights, processes and controls established internally and externally over the management of a business entity with the objective of protecting the interests of all stakeholders”.
1996	The Corporate Governance Handbook	“The relationship between shareholders and their companies Some agreement and the way in which shareholders act to encourage best practice (e.g., by voting at AGMs and by regular meetings with companies’ senior management). Increasingly, this includes shareholder ‘activism’ which involves a campaign by a shareholder or a group of shareholders to achieve change in companies”.
1999	OECD	"A set of relationships between a company’s board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined".
2009	IFC	CG comprises the “structures and processes for the direction and control of companies.”
2009	Walker Review	“The role of corporate governance is to protect and advance the interests of shareholders through setting the strategic direction of a company and appointing and monitoring capable management to achieve this”.

2014	Financial Times Definition of Corporate Governance	"How a company is managed in terms of the institutional systems and protocols meant to ensure accountability and sound ethics. The concept encompasses a variety of issues, including the disclosure of information to shareholders and board members, the remuneration of senior executives, potential conflicts of interest among managers and directors, supervisory structures, etc".

USA, for instance, responded with the Sarbanes–Oxley Act (2002), UK with the Higgs Report (2003) and the Smith Report (2003). The first code of corporate governance was published in the UK, by the Cadbury Committee in 1992 and in 1999 came the Principles of Corporate Governance by the Organization for Economic Cooperation and Development (OECD), which were later on revised in 2004 and now in 2014, they are yet again being revised (official website of OECD, 2014).To date, there are now approximately 101 modified codes around the world (ECGI,2014).

As far as defining the concept of corporate governance is concerned, financial crises in the last four decades (Tapia, 2013), the growing intricacies of the corporate world, the changing business environment, the case to case variation in the *modus operandi* involved in the series of mega corporate scandals and collapses around the world, the element of greed, the diverse legal traditions and jurisdictions have made it difficult to come up with a universal definition of corporate governance that could enfold all of its diverse dimensions and elements. Initially the definitions focused solely on financial perspectives and controls and corporate governance was taken as the system by which companies are directed and controlled and responsibility of governance was considered to lie with the boards of directors (Boyd, 1996; The Cadbury Report, 1992).

The definitions later on expanded and took corporate governance as a web of relationships between not only the company and shareholders but also between company and other diverse stakeholders (OECD, 1999). Accountability, transparency, fairness and disclosure are now deemed as the four key "pillars" of the good corporate governance system (Bhasin, 2013). It delivers structure and plan by which the goals of the firms are set and the ways for achieving the goals. Furthermore, it also offers structure to monitor the firm performance.

1.2 Is Corporate Governance Effective?

Corporate governance is a system of relationships, defined by structures and processes. For instance, it is a relationship between stakeholders, primarily the shareholders/investors/financiers and management wherein, the former provide capital to the latter and expects returns on investment. On the one side, the internal structure is presumed to facilitate setting and achieving of organizations' objectives and provision of controls for monitoring performance and efficient use of resources, while on the other, managers are expected to provide assurance to the stakeholders of their investment being safe through regular and transparent operational/financial reports. Good corporate governance is also structured to prevent conflict of interest by providing proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders (OECD, 2004a).

Most of the codes mandatorily require transparency, disclosure and accountability on part of the management and the boards. The role of external and internal auditors too has been strengthened over the period of years. The stakeholders usually rely on published annual reports, backed by auditors' reports as these are presumed to portray a comprehensive and true view of the firm's financial and administrative performance. But, in major corporate scandals, stakeholders apparently were misled by sound annual reports, while the facts later on, revealed presence of gross management misconduct, fraudulent financial reporting, auditing issues (Soltani,2012), questionable accounting practices, (Bhasin, 2013), corporate greed and earning manipulations, (Yallapragada et al., 2012).

The increase in corporate frauds over the years has stirred a lot of research and scholars and practitioners are still in search, of significant gaps that lead to such collapses. Lots of research has been done to find ways to restore lack of investors'/public confidence, and find ways to prevent similar future occurrences. The potential solution maybe linked either to gaps in corporate governance framework, or to governance practices.

2. Research Motivation, Contribution and Methodology

This paper aims to categorize prominent factors responsible for corporate collapses and that too of reputedly sound corporate giants during the period 1990-2014. The said collapses not only affected their relevant markets, but also sent shock waves through stock markets all over the globe. The main motivation is to look for some sort of pattern common to all the taken up cases that could work as a warning scorecard. 55 cases from around the globe, over the span of 24 years in all, were selected for the study. The criteria of selection were based on the review of literature pertaining to corporate scandals including News Articles, books, legal documents and research papers. The breakup of the literature sources is given in Table 3.

Table 3: Review Sources

Books	12
Conference papers	5
Research Papers	32
Theses	3
Websites	28
Quasi-judicial/legal documents	25
Newspapers/Magazine Articles	43

The cases that appeared more frequently and had an element of notoriety about them along with being known as 'substantially shaking' the investors' and shareholders' trust were subsequently selected. The cases include not only the ones which have survived the crises despite loss of reputation and financial impairment such as Ahold, but also those that were reorganized, such as Vivendi, Tyco and Waste Management, along with cases like Enron, Daewoo, Andersen and Lernout and Hauspie, that actually failed (Wearing, 2005).

3. Descriptive Analysis

A number of prominent features were highlighted through analyses. The role of the higher management, the role of auditors, the role of regulating authorities, the

shareholders reactions, the impact as well as the civil and criminal ramifications had a lot of similarities as well as distinguishing features.

3.1 The Most Common Countries

The cases taken under study were from 16 countries, wherein approximately 53% of the cases belonged to the United States of America (USA), and almost all falling in the category of corporate frauds (Figure 1). Since the collapse of Enron in 2001, a series of scandals emerged involving major corporations. The second in ranking is United Kingdom (UK) with 9% of the cases.

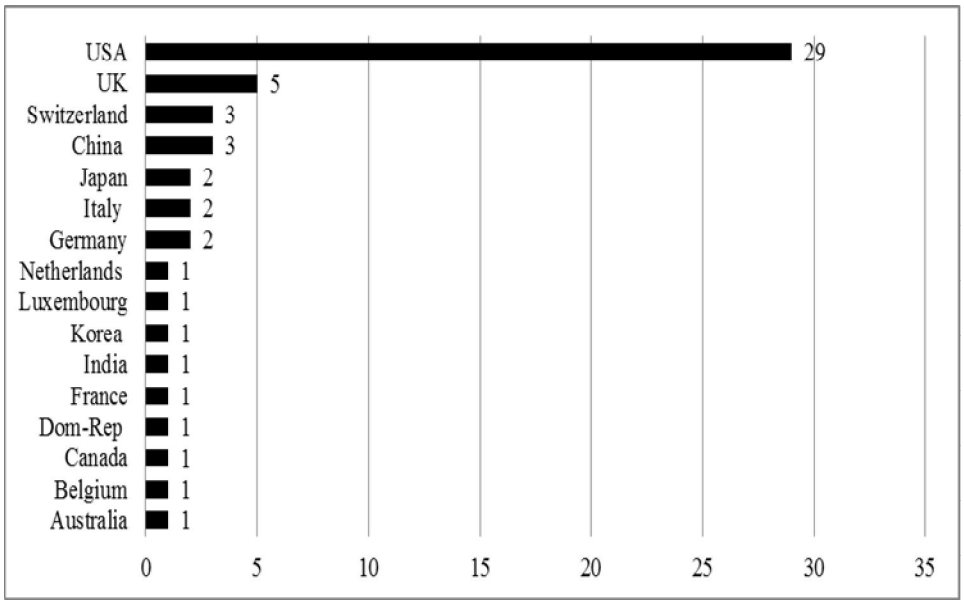

Figure1: Country–Wise Breakup of Cases

3.2 The Most Scandalous Year

From Polly Peck in 1990 to GlaxoSmithKline in 2014(Burkitt, 2014), corporate scandals have rocked the financial world, time and again. As per Figure 2, the majority i.e. 35% of cases are clustered in the year 2002, cropping up in USA, China, Canada, France, Sweden, Switzerland, Belgium and Germany (Wearing, 2005). The years depict the time when fraud was unearthed, although the corporations had been involved in fraudulent activities long before coming to light. Few of the cases such as the Peregrine Systems' scam, a software company, deceived the regulators for 20 years with fake e-mails and forged bank documents (Philips, 2012). Whereas, Bernard Madoff operated over a span of 40 years to cheat his 8000 investors (Geis, 2013).

The wave of these scandals has played a catalytic role in corporate governance drive in many of the countries. Cases like Polly Peck in 1990, Maxwell and BCCI in 1991, had an important role to play in the UK company law reforms and development of UK's code of governance (Giles, 2012). Similarly, corporate crises such as Enron in 2001, Tyco, World Com and Global Crossing in 2002 seem to be instrumental in formation of the Sarbanes– Oxley Act, 2002 in the USA (Wearing, 2005). SAirGroup (Swissair), a major

international airline was popularly known as the "Flying Bank" due to its financial stability, filed for bankruptcy in 2001. The entire Swissair management board faced criminal charges for mismanagement, forgery and false statements. Corporate governance in Switzerland is now divided into ‘pre and post Swissair’. Ahold, the Dutch food retailers, the “Europe’s Enron” happened in 2003 (The Economist, 2003) and stimulated a debate in The Netherlands, and a

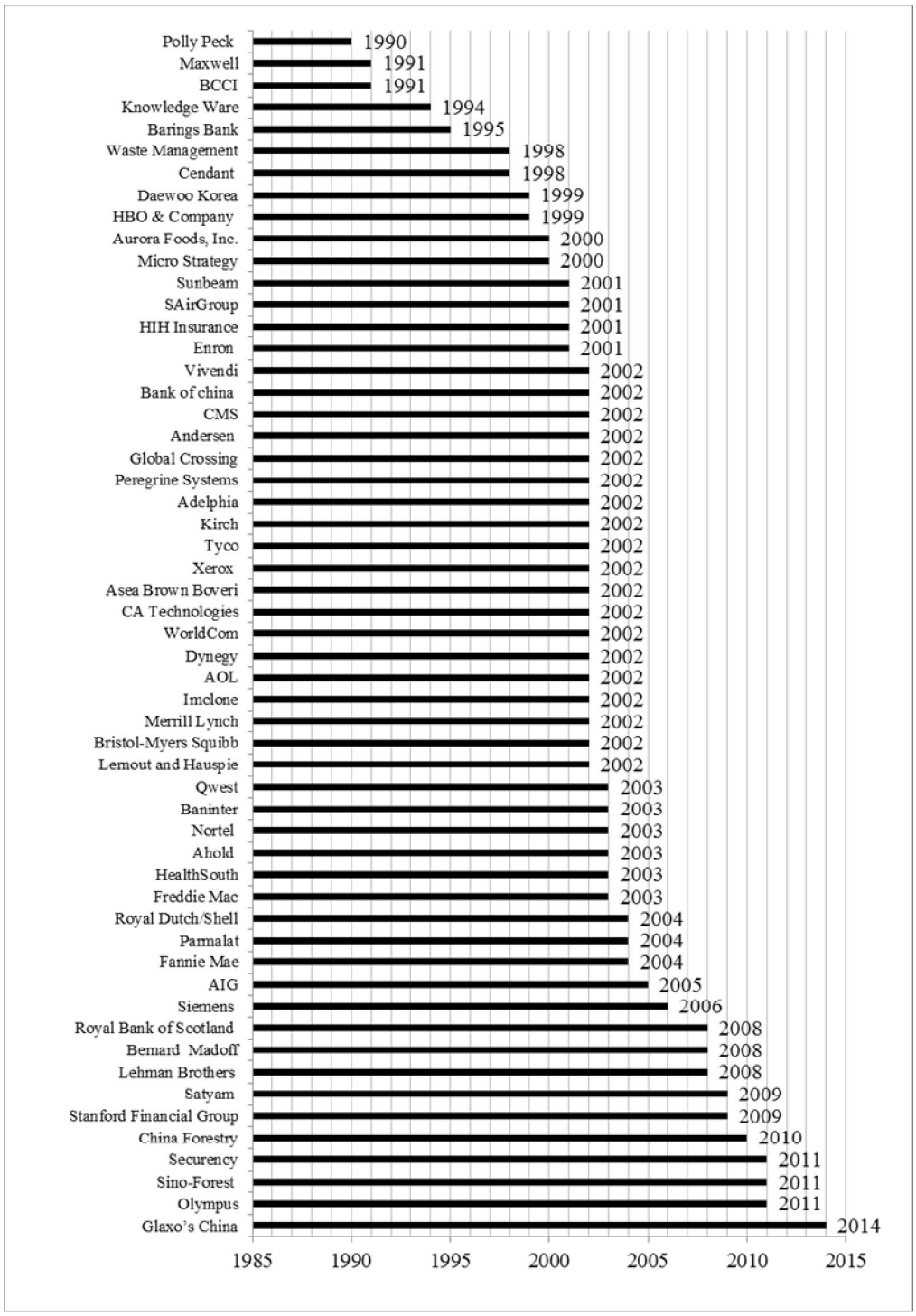

Figure 2: Year/Country–Wise Breakup of Cases

Tabaksblat Committee on corporate governance was installed to restore confidence in public companies. Ahold was also used by the USA to extend the 'Public Company Accounting Oversight Board (PCAOB)'s supervision to European accounting firms working or listed in the USA (Jong et al., 2005).

In France, it was the Vivendi Universal case in 2002, that influenced the role of audit committees and increased the corporate governance efforts and SAirGroup (Swissair) case in 2001 has had a similar effect in Switzerland (OECD, 2004b).

3.3 The Main Players and their Fates

In majority i.e. 83% of the corporate collapses, the Chief Executive Officers (CEOs) have been held liable for the fraudulent activities along with involvement of 77% of the Chief Financial Officers (CFOs), 57% of the other top executives including the ones present on the boards. The Boards in most of the cases have been found to be CEO-friendly and not objecting to any rash or negligent decisions of the CEOs. For instance, 'CEO-friendly' board of Vivendi Universal, a French utility company, cost the company a $25 billion loss, and never questioned the CEO for jeopardizing the financial future of the firm through a 'series of expensive acquisitions' spread over a multi-year period. In 2002, only after the group came down, that the loyal board members forced the CEO to resign (Banks, 2004). The chairman- cum-CEO was convicted in litigation filed by the shareholders accusing the company of fraud and deliberate overstatement of the group's financial health.

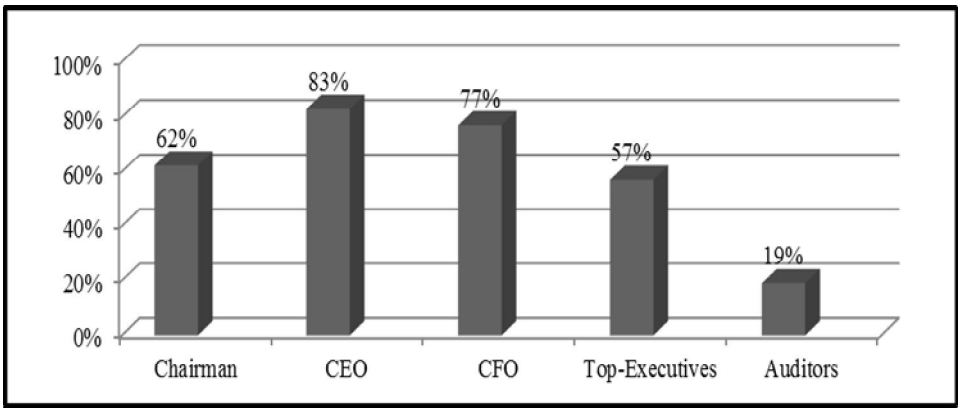

Figure 3: The Main Players

3.4 The Repercussions

In 72% of the cases the main culprits have been penalized and sentenced to jail. For instance the CEO of Polly Peck was charged with 18 offences of theft and false accounting in 1990. The Polly Peck administrators also sued him for £378m in the civil courts, and by creditors who claimed a further £80m from him(Wearing, 2005). He fled away to escape the criminal liability, but upon his return in 2012, the Chairman-cum-CEO, was sentenced to 10 years in prison on 10 counts of theft and for stealing £29m from his Polly Peck empire by a UK court(Neville, 2012; BBC news, 2012).

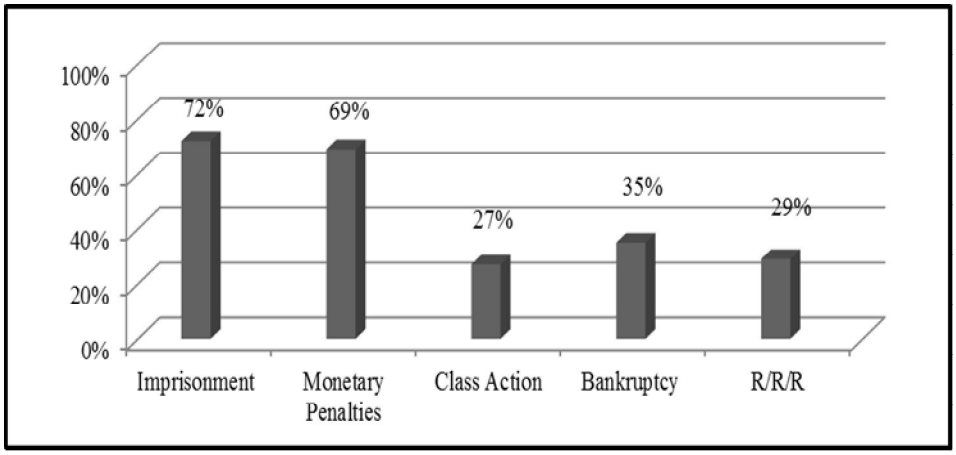

Figure 4: The Repercussions

Keeping in view the magnanimity of the losses, USA has been the harshest when it comes to punishing the corporate offenders. In 2007, Chairman and vice chairman in Cendant case received a 12 years punishment and fines amounting to $3.3 billion for inflating financial results. On the other hand, former Enron Chief Executives got a sentence of 24-years with $183 million fine in 2005, and former WorldCom chief executive was sentenced to 25 years term in 2006 with a fine of approximately$45 million. Although, all the three corporations were tried in the USA, but the variance in punishments is due to the date of filing of the cases. The latter mentioned cases were filed after the passing of Sarbanes-Oxley Act in 2002, which has harsher and longer prison sentence for corporate frauds (Britt, 2007). Secondly, Enron and WorldCom have been the most loss incurring cases with $74 billion and $79.5 billion losses respectively. The longest prison term among the study cases has been in the Madoff case, wherein, the CEO was sentenced to 150 years and a restitution of $175 billion in 2008.

3.5 The Modi Operandi& Causes of Action

"Modus operandi (plural Modi Operandi) is a Latin phrase, approximately translated as "method of operation"(Douglas et al., 2006). In other terms, it is the fact or combination of facts that gives a person the right to seek judicial redress or relief against another. In the cases under study, the main *Modi Operandi* that has been observed are false documentation & falsification of accounts to deceive the auditors, regulators and the shareholders. Almost all of the corporations have been guilty of mismanagement by flouting the Principal Agent relationship.

Table 4: Modi Operandi

S. #	The main causes of action giving rise to civil suits and criminal prosecution	Percentage
1	Forgery	7%
2	Falsification of accounts	70%
3.	Misappropriation of funds/embezzlement/theft	32%
4.	Bribery	5%
5.	Breach of trust	7%
6.	Disseminating false information to induce investment decisions	14%
7.	Fraud	49%
8.	Conspiracy	11%
9.	Obstruction of Justice	7%
10.	Ponzi Schemes	6%
11.	Money Laundering	2%
12.	False authentication of documents	6%
13.	Mismanagement	15%
14.	Poorly performed acquisitions	6%
15.	Insider Trading	6%
16.	Round-trip trading	4%

Instead of protecting the interests of the stakeholders, there has been misappropriation of shareholders' and employees' funds, deceptive practices to defraud investors and creditors, resulting in convictions for fraud, embezzlement and breach of trust. In the Maxwell case (1991) for instance, assets were pledged as security for additional loans and the CEO misappropriated employee funds (Spalek, 2001). Bank of Credit and Commerce International (BCCI), systematically defrauded its auditors over a number of years by falsification of accounts, to hide the losses and show healthy reserves (Kanas, 2005). Enron was placed in the USA's Fortune top ten list of firms. It was a leading energy commodities and service with revenue of US$101 (Cunningham and Harris, 2006). The company showed seemingly healthy profits by using 'Special Purpose Entities(SPEs)' to hide losses. Named by Enron staff as 'Raptors', the SPEs appeared to be part of hedging plan, but in fact they were used to hide losses and debts away from the published financial statements (Wearing, 2005). It was declared one of the biggest bankruptcy cases in the US history and is considered as the poster child for greed and fraud (Biegelman and Bartow, 2012). Parmalat, an Italian based global food and dairy conglomerate, founded by Calisto Tanzi., falsified its accounts, again to hide losses. The fraud was discovered when it was unable to pay its debt of about €150 million. Its financial advisors destroyed documents to cover tracks and Calisto Tanzi was given ten-year sentence for maintaining false accounts and misleading the investors and regulators (Bhasin, 2013).

The Barings Bank case in 1995, is an unusual case where, Nick Leeson a 'Derivatives Trader', traded on his own behalf instead of trading for his clients and, to hide his illegal activities, he forged documents , and created a fake account known as the' 88888' account to mask the losses. A bank that had been in business for 200 years, collapsed due to the unauthorized actions of one individual (Drummond, 2003; Drennan, 2004). Lernout and Hauspie, a Belgian technology, communications and a software company, was found guilty of being involved in a multi-year financial fraud and fabricated at least 70 percent of its reported sales and also used shareholders' money to boost its stock price (Banks, 2004). Satyam Computer Services Limited, based in India, overstated its profits and documented fictitious assets. The case is known as India's Enron (Atesci et al., 2010; (Rishi and Singh, 2011 and Singh et al., 2010). Securency, a Reserve Bank of Australia (RBA) subsidiary, in 2012, was found to be indulged in corruption and bribery to secure contracts (FCPA, 2012). Lehman brothers, the fourth-largest investment bank in the US faced 'the largest bankruptcy filing in USA. history' in 2008. It hid $50b in loans by classifying them as sales. Its Audit firm, Ernst & Young too was involved and manipulated the books by using "Repo 105", an accounting trick, which temporarily moved $50billion of assets at the end of each quarter, making them appear as less dependent on loans then they actually were. Eventually, 26 thousand people became unemployed and millions of investors lost all of their money (Swedberg, 2010). *"The bankruptcy examiner's report in the bankruptcy of Lehman Brothers is a portrait of accounting manipulation and fabrication that stands next to Enron as the epitome of structured financial statement fraud"*(Rodriguez, 2010).

The executives involved in Arthur Andersen, Enron and Imclone scams were convicted for obstruction of justice. Asea Brown Boveri (ABB), a Swedish company, termed as the 'Swedish version of Enron' (Bloomberg Business Week, 2002) filed for bankruptcy in 2001, due to its aggressive and unfocused 'acquisition spree' that lasted for 10 years. ABB bought on average of 20–30 companies per year, including those with known history of losses and significant liability claims, (Wearing, 2005). The Madoff investment corporation defrauded its investors of $64.8 billion by running the largest Ponzi scheme in history (SEC, 2008). Companies like CMS Energy Corp. and AOL Time Warner in 2002 were found involved in deceptive round trip trades and 'Fraudulent Round-Trip Transactions to Inflate Online Advertising Revenue' respectively (SEC, 2004; SEC, 2005).

Most of the corporations were charged and convicted, as also held civilly liable on various counts and almost all of the corporations have been guilty of securities/accounting frauds. The most common *Modus Operandi* or cause of action that has been identified in this study is falsification of accounts, be it for overstating earnings or for hiding losses, whether to deceive auditors or to defraud investors.

Also, almost 49% of the corporate executives have been charged for fraud and intentional dishonesty and 31% have been liable for Misappropriation of funds/embezzlement/theft of company's and shareholders'/investors'/employees' funds(Table: 4).

3.6 The Warning Signs

All the corporations that collapsed, were corporate giants in their own fields, mostly praised by financial analysts, and had strong market repute and rich annual reports. But all fell a prey to either over ambitiousness or greed of their top notch executives, who

indulged in high risk ventures in order to expand. Hence the aggressive and speedy growth and expansion of any corporation, is the only warning sign that ought not to be ignored and should be examined skeptically by any shareholder or investor before investing.

4. Discussion, Limitations and Conclusion

4.1Discussion: The Corporate Governance Failings-Highlights and Pattern

The diverse *Modi Operandi* as discussed in the last section gives rise to a few questions, such as:

- Why were the audit controls not effective?
- Why could not the external auditors detect fabrication or falsification of accounts?
- What took the regulators so long to detect fraudulent activities and forged documentations?
- Why did not the directors and the boards question mismanagement, embezzlement and bad investment decisions?

The mega ponzi scandals like that of Madoff's and Stanford's continued for decades and the regulators could not detect them. The Chairmen and CEOs such as of Vivendi Universal and Asea Brown Boveri were exercising 'uncontrollable control', taking single handed decisions and making poor investments and the directors remained silent participators. The CEOs and CFOs of Enron, WorldCom etc. conspired to falsify accounts to cover up losses, and the top five-Auditors either could not detect illegalities and irregularities therein or were abettors thereto.

4.1.1 Why Did the Flouting of Rules, Deception and Breach of Trust Go Unnoticed?

The study highlights various factors (Table: 5) that might possibly explain and answer the above stated questions related to failures of corporations in corporate governance. Such as, adverse effects of abuse of too much power in the hands of the founder/chairman and CEO of an organization, particularly if both posts are held by the same person, have seen to be devastating for the company itself and the stakeholders attached to it. The results reveal involvement of the chairmen and CEOs in more than 80% of the under-study mega-corporate scandals.

Table 5: Common CG Failings and Possible Explanations

#	Common CG Failings	Possible Explanations
1.	Failure of internal audit	— Rapid expansions — Audit controls appeared to have been nonexistent or were severely flawed — or the internal auditors were powerless — or there were pressures to meet analysts demand
	Failure of Audit committees	— flawed committees — powerless
2.	Failure of external Audit	— Conflict of interest
3.	Ineffective Directors/ Boards	— Abuse of power at the top — Charismatic leadership — Tone at the top — Trust theory/Loyalists — Conflict of interest — Fear/greed
4.	Delayed reactions of regulators	— Insufficient skill to detect frauds from financial disclosure — Corporate lobbying deprives the regulators of political mandate

The litigious CEO of Maxwell (1991), aggressive CEO of Daewoo Group Korea(1999), ambitious CEOs of Ahold(2001) and Vivendi (2002) , charismatic and dominating CEO of WorldCom(2002) and all the rest have seen to be powerful, most of them politically influential, were over ambitious and dominated the boards. They indulged into high risk, aggressive and speedy expansion strategies. Being loyalists and CEO friendly, the boards never made an effort to question any quick or risky ventures. This led to slackness of internal audits. The internal controls, that were already weak or flawed, could not cope up with the speedy and complex expanded structures. The study does not also find support for a significant role of Audit committees. Consequences were oversights, errors and bad judgment. In the case of Enron (2001), Sherron Watkins an accountant, tried to bring her concerns to the attention of her superiors, but Enron's audit committee being ineffective failed to prevent Enron's collapse. Royal Dutch/Shell Energy Group in 2004 announced 20% downgrading of its reserves, which led to a quick decline in its share price. The reserves had been overstated in the 2002 as per a subsequent internal investigation report in 2004. Among reasons identified were deficiencies in internal controls and undertrained and understaffed internal reserves audit. Moreover, the audit committee of Shell did not receive or rather could not receive information to handle the issue (Wearing, 2005). At WorldCom (2002), Cynthia Cooper, an internal auditor, became a whistle blower and did inform the audit committee of the dubious accounting transactions. However, the committee's independence was questionable and it failed to act on the information.

The position of the boards of directors in these mega corporate collapses had not been any different either. Asil Nadir, who was both the chairman and chief executive of Polly

Peck International (1990), though could not always win over his board to agree to his expansion strategies and corporate purchases, but got away with their approval by intentionally keeping them uninformed. In case of Parmalat (2004), the CEO intentionally kept the board in the dark. The concentration of too much power in one hand also played its toll in the WorldCom's collapse (2002). The board was dominated by Ebbers, partly because they trusted his business skills, and partly because of the fear that he might sell large amounts of his shareholdings in WorldCom.

The external audits seemed to have failed too, mainly because of their conflict of interests. Except for a couple of cases like that of Lernout and Hauspie, wherein the external auditors blew the whistle, the study does not find the active role of the external audits. For instance, the financial reporting irregularities were overlooked by the external audit firm, Arthur Andersen, who had a conflict of interest as it carried out audit and non-audit services such as mother management consultation work. Arthur Andersen received $25m for audit services and $27m for non-audit services in 2001. Going against Enron's management meant losing other lucrative services. But as the fraud started to unfold, Andersen shredded and deleted documents and the lead auditor later on admitted to obstruction of justice. Seven months after the Enron's filing, Andersen too filed for bankruptcy(Banks, 2004).

The 'tone at the top' i.e. the ethical atmosphere created by the organization's leadership, provides moral and behavioral standards for all in an organization. The leadership of the organizations under study, be it Securency (2001), or Seimens (2006), or Health South Corporation (2003), or Baring (1995), or HIH (2001) etc., the tone at the top lacked integrity and morality. The tone at the top is reflected by flouting of rules in form of falsification of accounts, forgery, deceptive sales, financial misstatements, fraud, theft, embezzlement, harassment, and corruption. In almost all the cases under study, the main factor behind was corporate greed, which manifested itself in the form of over ambitiousness, resulting in destruction of companies, unemployment along with huge losses to investors and shareholders.

The regulatory oversight has not been efficient, due to lack of technical skills. To detect fraud from a company's financial position and disclosure reports requires a particular expertise. The corporate lobbying too has been a factor in poor detection of fraudulent practices (Banks, 2004).

4.2 Limitations

There are a number of limitations of this study, such as, only a small number of cases have been studied, and secondly all involve financial losses. Cases of corporate failures in terms of losses and injuries to human lives occurred such as in Bhopal case in 1984 has not been taken up. Corporate structures, diverse jurisdiction and legal regimes wherein the corporations operated, Board sizes, levels and structures too have not been discussed and neither is the study industry specific. Although, the variation in the industries, countries and board structures of the corporations studied in this paper belonged, seem to have made no difference. The companies under study operated in assorted sectors and belonged to different legal jurisdictions, but that too has apparently made no difference, as neither the cause of action nor the consequences are dissimilar, though there is difference in degree of intensity of losses and punishments.

4.3 Conclusion

The Country wise analysis reveals that 53% of the corporate frauds initiated in USA, followed by UK and other countries and the majority of fraud cases i.e. 35% were reported in 2002, all of them categorized as mega corporate collapses and frauds, that compelled the need for governance reforms, resulting in laws like the Sarbanes-Oxley (SOX) Act of 2002, Cadbury Report 2002 and a drive at international level. More and more CG codes are updated on yearly basis to prevent corporations from indulging in fraudulent activities. Consequently, the industries around the world are facing high amount of regulatory and reporting obligations and are compelled to spend on regular basis for the improvement of internal control mechanism and CG to fulfill the national and international requirements. However, Reported frequency of falsification of accounts and financial statement practices have raised concerns on the integrity and reliability of financial disclosures and has shaken credibility of the country's financial reporting practices. Furthermore the results also reveal the questionable performances of top management, internal and external auditors, regulatory bodies, and credit experts. There is frustration among stakeholders over the failure of experienced and well-known, famous auditors to detect such frauds prior to the announcement of the firm's reports. In majority of the scams, the Chief Financial Officers (CFOs) and Chief Executive Officers (CEOs) are held responsible for cooking the books and therefore penalized and even sentenced to jail. These corporate frauds are widespread, costly, and multifaceted and have left adverse effects (Alleyne and Elson, 2013). Since Polly Peck in 1990 to Enron in 2001 and to Olympus in 2011, the corporate governance system has developed quite a bit. However, corporate integrity is still at stake, as the latest scandal has hit china only recently, and the websites of corporate regulatory authorities around the world are still hogged by complaints against false accounting statements, fraud and embezzlement.

In major corporate scandals, stakeholders apparently were misled by sound annual reports, while the facts later on revealed presence of gross management misconduct, fraudulent financial reporting and auditing issues. In their zest and greed for aggressive and speedy expansions, the firms failed to observe corporate governance practices and rules, resulting in huge losses to the stakeholders. The aggressive and speedy growth and expansion of any corporation, has been found to be a common warning sign that should be examined skeptically by any shareholder or investor before investing.

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