

# AN ANALYSIS OF MAJOR CORPORATE SCAMS IN INDIA WITH SPECIAL REFERENCE TO SECURITIES MARKET

Written by *Mayank Shrivastava*

*Research Scholar, Amity University Raipur Chhattisgarh, India*

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## ABSTRACT

Frauds have been rampant in the business world, and India has had its share of corporate frauds. The incidents of corporate frauds have significantly impacted the stakeholder's confidence. The scope of a fraud is no limited to monetary figure. It, in most of the instances has made the organization part with its reputation, goodwill and what not. Many large corporations maintain consistently good record of ethical practices and compliance with the law that contrast sharply with the behavior of other corporations. The reasons for these differences present several important issues.

Corporate frauds and abuse of position have been seen in various cases relating to scams, malpractices, insider trading price rigging etc. like Harshad Mehta Scam, Ketan Parekh Scam, Satyam Scam, Sardha Chit Fund Scam, Sahara Scam, PACL, IPO Scam etc.

The wrongdoers in case of corporate scams are not like those other criminals, rather they are in most of the cases such sharp minded people that they know how to find the lacunae even better than even the makers of the Law. Finding the loopholes in the existing procedure is where a corporate scam starts. The brilliant a mind, severe the corporate crime, these perpetrators of corporate scams are more brilliant, soft spoken, smart and intelligent. They are well versed with the law, in the sense that they have not only read and understood the parent legislation and regulations but they have also interpreted in the manner that they know how to make use of the law for their own sake.

Fraud is an intentional deception or a willful misrepresentation of a material fact and includes lying, cheating and stealing. It consists of coercing people to act against their own best interest. However when we talk about corporate crimes, frauds and scams, they are majorly concerned

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with all those economic offences that cause harm to the investors money and are usually done by the persons who are having the real or apparent authority.

## **CORPORATE SCAM: A GENESIS**

The first and foremost thing that comes into mind when we talk about the scams is that what exactly a corporate scam means and as in the introduction of the paper it is mentioned that frauds and scams belong to the same genus, we need to know the detailed meaning of them, if they are used alternatively.

Corporate fraud consists of activities undertaken by an individual or company that are done in a dishonest or illegal manner, and are designed to give an advantage to the perpetrating individual or company. Corporate fraud schemes go beyond the scope of an employee's stated position, and are marked by their complexity and economic impact on the business, other employees and outside parties.<sup>i</sup> Though such corporate frauds may be conducted in a variety of ways, most frequently they are performed by taking advantage of confidential information or access to sensitive assets, and then leveraging those assets for gain<sup>ii</sup>

The fraud is often hidden behind legitimate business practices or exchanges in order to disguise the illicit activity. For example, the accounting for a company may be altered to present an image of high revenue and profits compared with the actual financial results. These actions might be taken to hide shortcomings such as a net loss, slow revenue, declining sales, or hefty expenses. The falsified accounting might be done to make the company more attractive to potential buyers or investors.<sup>iii</sup>

Other forms of corporate fraud may aim to disguise or misrepresent a service or product the company is developing or has in service, hiding its flaws or defects. Rather than invest in repairing, refurbishing, or redesigning the product, those responsible for the product attempt to deflect or disguise these issues. This might be done if the department or company does not have the finances to correct the problem or if revealing the issue might drive away customers and investors.<sup>iv</sup>

There are multiple types of corporate frauds/scams that the Indian securities market has witnessed like theft of any movable physical asset from the corporate house or offices,

embezzlement of funds and misuse of accounts and the related information of accounts, frauds related to procurement of funds, frauds relating to payrolls, wrong description in the financial statements, misstatement in the prospectus, fraud as to suspense accounting and floating of funds, frauds related to employment credentials, floating a ponzi scheme <sup>v</sup>, claims of fraudulent expenses, bribery, corruption etc.

In any fraud, there lies two aspects, an internal active role and an external inactive role, we can better understand this thing in the manner that any big scam is when revealed it is found and observed that on one hand it was the fault of the internal management, key managerial persons and responsible authorities, while in the other hand the external auditing company also fails to discharge its duty accordingly or deliberately does not perform its duty in the required manner.

### **PRE-SEBI PERIOD AND SCAMS (1947-1992)**

The securities market got its first familiar legislation in 1947, soon after the independence in the form of Capital Issues Control Act<sup>vi</sup>, then there was more enlightenment to the way in 1956 when both, the Companies Act<sup>vii</sup> and the Securities Contract (Regulation) Act<sup>viii</sup> were legislated. After this the financial market got some sort of directions as to how the regulations are to be made and followed. This era was however a little weak era if the capital market is concerned because there was a lack of any authority which could have acted as a strict regulator. The CCI tried controlling and regulating the market but it lacked in many ways which have been mentioned in the earlier chapter. Thus, in this era, frauds and unfair practices took place in the market but majorly were such that were not recorded.

The same can be highlighted in the following manner-

In the initial phase of CCI, the major issue involved in the market was related to the lack of skills and expertise in the field to evaluate and analyze the market well, thus any person who had sufficient knowledge and good skills relating to the market was at the edge of committing fraud as he had privilege over anyone else, the training and development programs are a part of recent developments they were not so active by that time.

Probably the first major corporate scam related to securities market in Independent India was what is referred to as *Mundhra Scam*. Hari das Mundhra, an industrialist and stock speculator,

sold fictitious shares to the Life Insurance Corporation of India (LIC) and thereby defrauded the corporation by Rs 1.25 crores in 1957. This amount at that time was no way less than a thousand crore of today. He was found guilty and was sentenced for imprisonment for 22 years. The then Union Finance Minister, T.T. Krishnamachary had to resign from his prestigious post in the face of scathing criticism within and outside Parliament.

The Mundhra scandal exposed the nexus between the Bureaucracy, stock market speculators and small rogue businessmen. It also brought to light rifts between the then Prime Minister Jawaharlal Nehru and his son-in-law Feroze Gandhi<sup>ix</sup>

After the Haridas Mundhra case of 1957, another major scam in the mid-sixties and early seventies was associated with *Jayanti Dharma Teja*.<sup>x</sup>

J D Teja availed loans from banks and financial institutions and used this easy money to establish a shipping empire, in the name of Jayanti Shipping Company Limited. While he had set up this company with a paid up capital of a mere Rs 200/- and took government loans amounting to Rs 22 Crores, Teja evaded government taxes and committed fraud by many ways.

Firstly, he, in collusion with his second wife, produced a forged resolution of the Board of Directors of the Company authorizing him to be the sole beneficiary of a letter of credit for \$1,200,000.

Secondly, by using forged documents and making false statements, he withdrew \$ 1,36,800 from his wife's personal account.

Thirdly, he misappropriated \$87,600 paid by the Norwegian company for the charter of a ship.

Lastly, he fraudulently retained a two percent commission on the amount paid by his company to Mitsubishi International Company for building 11 vessels for the company.

Teja was charged with offences under Section 409<sup>xi</sup> and 467<sup>xii</sup> of the Indian Penal Code, which are punishable with imprisonment for life, together with offences under section 420,<sup>xiii</sup> 477A<sup>xiv</sup> and 120B<sup>xv</sup> of the IPC for the embezzlement of the funds amounting to about two crore rupees in foreign exchange out of the funds belonging to Jayanti Shipping Company of which he was the permanent chairman.<sup>xvi</sup>

## **POST SEBI PERIOD AND SCAMS (1992-CURRENT)**

So as we saw that prior to SEBI, there was a major problem related to the regulations as there was lack of a proper governing authority that led to such bare and naked scams but later when SEBI came into existence and assumed in itself the powers as the primary regulator of the market, the scenario took a shift.

The same can be seen in the following cases as mentioned below-

Georg Hegel, a German philosopher once said: *“We learn from history what we do not learn from history.”* This quote is very apt, especially in the light of all the recent securities market scam. Why? Because back when India had just opened up its markets to the world in 1991, a stock broker named Harshad Mehta had pulled off an even more audacious scam by exploiting the loopholes in the Indian banking system. Adjusted for inflation today, Harshad Mehta fraudulently laundered over Rs 24,000 crore in the stock market over a three-year period.<sup>xvii</sup>

### ***The Harshad Mehta Case (1992)***

Born in a Gujarati family, Harshad Mehta was a stockbroker, and is reported to have engineered the rise in the Bombay Stock Exchange in the year 1992. Starting as a dispatch clerk in the New India Assurance Company Ltd. He along with his brother Ashwin developed interest in the stock markets operations,

Harshad Mehta started his venture by establishing a company known as Grow More research and Asset Management Company Limited.

Mehta gradually rose to become a stock broker on the Bombay Stock Exchange and developed an expensive lifestyle. He rose and survived the Bear Runs. This earned him the nickname The Big Bull of the trading floor. By 1990, Mehta was purchasing shares heavily. He used to purchase heavily in order to rise the value of shares substantially, the major shares he purchased and gave positive way were of ACC Cement that reached from 200 to 9000.

In 1992, Harshad Mehta was blamed for being the major reason for the crash in the securities market. The two major scams that have happened in 1992 that led to such crash were

- Stamp paper scam

The Rs. 2200 crore "stamp paper scam" of 1992 initially involved the printing & selling of stamp papers. It involved fraudulent printing & sale of stamp papers in various parts of the country, including by the likes of a young high school pass out in a small town of Karnataka, Telgi. Up to the early 90s, banks in India were not allowed to invest in the equity markets. However, they were expected to post profits and to retain a certain ratio (threshold) of their assets in government fixed interest bonds. Mehta cleverly squeezed capital out of the banking system to address this requirement of banks and pumped this money into the share market. He also promised the banks higher rates of interest, while asking them to transfer the money into his personal account, under the guise of buying securities for them from other banks. At that time, a bank had to go through a broker to buy securities and forward bonds from other banks. Mehta used this money temporarily in his account to buy shares, thus hiking up demand of certain shares (of good established companies like ACC, Sterlite Industries and Videocon) dramatically, selling them off, passing on a part of the proceeds to the bank and keeping the rest for himself. This resulted in stocks like ACC (which was trading in 1991 for Rs. 200/share) to nearly Rs. 9000 in just 3 months.<sup>xviii</sup>

- Bank receipt scam

Another instrument used in a big way was the bank receipt (BR). In a ready forward deal, securities were not moved back and forth in actuality. Instead, the borrower, i.e. the seller of securities, gave the buyer of the securities a BR. The BR confirms the sale of securities. It acts as a receipt for the money received by the selling bank. Hence the name - bank receipt. It promises to deliver the securities to the buyer. It also states that in the mean time, the seller holds the securities in trust of the buyer.

Having figured this out, Mehta needed banks, which could issue fake BRs, or BRs not backed by any government securities. Two small and little known banks - the Bank of Karad (BOK) and the Mumbai Mercantile Co-operative Bank (MCB) - came in handy for this purpose.<sup>xix</sup>

Once these fake BRs were issued, they were passed on to other banks and the banks in turn gave money to Mehta, plainly assuming that they were lending against government securities when this was not really the case. He took the price of ACC from Rs. 200 to Rs. 9,000. That

was an increase of 4,400%. The stock markets were overheated and the bulls were on a mad run. Since he had to book profits in the end, the day he sold was the day when the markets crashed.<sup>xx</sup>

It was alleged that Mehta engaged in a massive stock manipulation scheme financed by worthless bank receipts, which his firm brokered in "ready forward" transactions between banks.

Exploiting several loopholes in the banking system, Mehta and his associates siphoned off funds from inter-bank transactions and bought shares heavily at a premium across many segments, triggering a rise in the BSE SENSEX. When the scheme was exposed, banks started demanding their money back, causing the collapse. He was later charged with 72 criminal offences, and more than 600 civil action suits were filed against him.<sup>xxi</sup>

He was arrested and banished from the stock market with investors holding him responsible for causing a loss to various entities. Mehta and his brothers were arrested by the CBI on 9 November 1992 for allegedly misappropriating more than 2.8 million shares (2.8 million) of about 90 companies, including ACC and Hindalco, through forged share transfer forms. The total value of the shares was placed at ₹2.5 billion (US\$35 million)<sup>xxii</sup>

Mehta was convicted by the Bombay High Court and Supreme Court of India for his part in a financial scandal valued at ₹ 4999 Crores which took place on the Bombay Stock Exchange (BSE). The scandal exposed the loopholes in the Indian banking system, Bombay Stock Exchange (BSE) transaction system and SEBI further introduced new rules to cover those loopholes.

### ***The UTI Case (2000)***

The Unit Trust of India was an organization established by the Parliament as a mutual fund organization but was alleged to be the home to one of the most severe misuse of arbitrary powers and also insider trading, as the chairman was blamed to invest in the non secure stocks misusing his position and also of passing secret information to the outside parties to get his part of investment back with a better return. UTI kept on purchasing such non performing shares and also went on to purchase junk bonds. The public money was thrown to rich people at the cost of their innocent sum. Thousands of crores of the money raised by way of investment from

general public was passed to the rich persons through further investment by UTI. The chairman duped the millions of small investors through false propaganda and allowing profits to big companies which had invested in the UTI.

During two months before the freezing of dealings in the UTI shares, a huge sum of Rs 4141 crore was redeemed. Out of these 4000 were corporate investments made and further fraudulently made by the UTI. The small investors of UTI also lost because of the repurchase of shares at 14.20 when actual value was 8, they altogether lost around 1300 crores. The huge withdrawals and leakage of info deepened the crisis. <sup>xxiii</sup>

### ***The Ketan Parekh Case (2001)***

Following the infamous Harshad Mehta Scam, the securities market was a bit too concerned about these brokers and merchant bankers and tried finding ways for the proper control and regulation of these people or organization, but the market went shocked for the second time when in 2001 the Ketan Parekh Scam came into picture.

Ketan Parekh was a chartered accountant by profession. He was so good at the markets just like his predecessor in frauds, Harshad Mehta, that he also gained the title of Bombay Bull. Ketan Parekh used his good terms and contacts and made network of companies and held stakes in ABCL, HFCL, Mukta Arts, Satyam Computers, DSQ etc. The biggest bull on Dalal Street after Harshad Mehta caused one of the biggest wealth erosion, refreshing memories of the Harshad Mehta days. Ketan Parekh manipulated the market to suit his needs and unleashed one of the most maniacal episodes in India's financial history, but his picks continued to deliver regardless of their master's demise. Ketan Parekh took advantage of the low liquidity of the high growing companies and these companies were made to be known as K-10 stocks<sup>xxiv</sup>.

He pledged the shares with banks as collateral security at the time when the shares were trading at lower prices. When prices were high, shares were pledged as collateral for funds in banks. His modus operandi was to raise funds by offering shares as collateral security in the banks. When the prices crashed he was pressurized to add more security or return money. In 2000, he faced the major issues as to his K 10 stocks and the advantage taken by the International Bear Cartel, sensitive information was passed to the cartel and he in having an edge to the market took a loan of 250 crore from Global Trusts Bank and also took a loan from Madhavpura



Mercantile Bank of around 1000 crore. Every party providing loan to KP was exhausted and cheated, the SEBI launched an immediate investigation into the volatility of the stock markets.

This was the first time when not only the person actually but also the Board itself was held to be too lethargic and ignorant of even the bare facts. The reactive approach of the Board was criticized and it was expected from the Board to be a little more proactive from future.

This was the beginning of the real reforms to SEBI which took a concrete shape and structure after the market got one more serious shock in the year 2005 by the IPO scam and in 2009 by the Satyam Scandal. These scams have made ways for the market to reform itself.

### ***The IPO Demat Case (2005)***

This was the scam that was related more to the Depositories Act, 1996 and thus affected the market and added a new dimension to the frauds that were prior to this majorly related to the Company laws and banking laws incidental to the securities law.

The YES Bank entered into Indian market by Initial Public Offerings (IPO)<sup>xxv</sup> and numerous fictitious demat account<sup>xxvi</sup> were created to obtain the shares.

In 2005, SEBI found irregularities in these accounts and started an investigation as related to the IPO thing. The Board investigated and found that the IPOs of major companies including Jet, Punj Lloyds, IDFC, NTPC, PVR were also irregular. While the YES Bank was investigated many IPOs were found to be illegal, for the sake of increasing stocks and ancillary things. The Board froze these demat accounts and an amount of around 1200 crores was extracted from these fictitious frozen demat accounts.

### ***The Satyam Scandal (2009)***

One of the most devastating scandals that made the whole market go into shock and indeed the biggest corporate scam was the Satyam Scandal. This case was related to the manipulation of books of accounts completely, floating a sham company and also defrauding the external parties by a fake display of accounts. This case also for the first time showed that how the auditors have also been either indulged or a bit too lenient and ignorant in their task, they were also punished.

The promoters were the primary culprits, although it was almost impossible to misrepresent such facts without the connivance of the auditors and some executive board members. Independent directors, it seems, were kept in the dark about the actual books of accounts. The role of external third party auditors, who were tasked to ensure that no financial bungling is undertaken to carry out promoters' interest or hide facts, have also been brought to question.<sup>xxvii</sup>

The scandal broke in 2009 when founder-chairman of Satyam Computers Ramalinga Raju confessed that the company's accounts were tampered with. He disclosed a Rs.7,000-crore accounting fraud in the balance sheets<sup>xxviii</sup>.

In order to manage the reputation of the company, the accounts were being falsified for so long. The company never had that money, what the accounts showed from last many years. Satyam's Balance Sheets were overstated and the auditors PWC (PriceWaterhouse Coopers) role was also quite dubious.

Raju drew money as payment of salary to the employees who were in reality not even existing. The most former attempt made by Ramalinga Raju in the same context was the fake acquisition of a completely sham company namely MAYTAS, which is nothing but the opposite of word SATYAM. When this acquisition deal failed, only then this scam was identified and Raju confessed his fraud.

PWC audited company for almost 9 years and couldn't find the fraud which was found by the Merrill Lynch in almost 10 days.

Satyam scandal when came into picture made the corporate world realize the worth of Corporate Governance, and the importance of Independent Directors and impartial Auditors.

### ***Sahara Scam***

Sahara India Parivar was once one of the most diversified corporate house but it saw major decline in the 21<sup>st</sup> century when it tried and indulged into many non profiting business and also was found to be engaged into many unfair practices in order to defraud the stakeholders.

The famous case of Sahara v SEBI<sup>xxix</sup> was related to the jurisdictional issues of SEBI and the status of hybrid securities as to the regulations to be made by SEBI.

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 Subrato 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 (OFCB), 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 investors' money by depositing it with SEBI. Sahara then declared that most of the US \$3.9 billion had already been repaid to investors, save 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 Subrato 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 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.<sup>xxx</sup>

### ***Sardha Chit Fund Scam***

Sudipto Sen was the mastermind of this ponzi scheme<sup>xxxi</sup> scandal, the first of its kind in Indian Market. Sardha group was mainly active in the Eastern India and expanded its business in various ponzi schemes all over the eastern India focused on West Bengal.

The main fraud was conducted by way of Chit Funds business because when the Board wanted to investigate on the matter, the jurisdiction was challenged on the grounds that it came under the exceptions and this particular thing led to the amendments related to the Collective Investment Schemes in the Act.

The SEBI first challenged Saradha Group in 2009 as the Group opened more than 300 companies merely to defraud the Board and the customers by cross holding shares here and there with a way to confuse all the vigilant members of market and to make the company's structure more complex. The Group however ignored these warnings in the first instance and enhanced its business in Collective Investment Schemes (CIS) in hotel, manufacturing etc. investments were sold fraudulently as chit funds just to avoid the regulation by SEBI, chit funds being exception in the Act. The company acquired and sold large numbers of shares of various listed companies, and siphoned off the proceeds of the sale in unknown accounts. Sardha group ignored all the next warnings and continued to do such business until collapsed in 2013 causing an estimated loss of 200-300 billion to over 1.7 million depositories.

The Board ordered Saradha to close all its CIS and refund the money collected and barred the functioning till money was refunded. In May 2014, the Supreme Court of India, inter-state ramifications, possible international money laundering, serious regulatory failures and alleged political nexus, transferred all investigations into the Saradha scam and other Ponzi schemes to the Central Bureau of Investigation (CBI), India's federal investigative agency Many prominent personalities were arrested for their involvement in the scam including two Members of Parliament (MP) - Kunal Ghosh and Srinjoy Bose, former West Bengal Director General of Police Rajat Majumdar, a top football club official Debabrata Sarkar, Sports and Transport minister in the Trinamool Congress government Madan Mitra<sup>xxxii</sup>

## ENDNOTES

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<sup>iii</sup> Loosely based on Satyam Computer Services Scandal (April, 2009) available at [https://en.wikipedia.org/wiki/Satyam\\_scandal](https://en.wikipedia.org/wiki/Satyam_scandal) visited on Apr 15,2021

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<sup>vi</sup> Act No. 29 of 1947

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<sup>ix</sup> Available at [https://en.wikipedia.org/wiki/Haridas\\_Mundhra](https://en.wikipedia.org/wiki/Haridas_Mundhra) visited on Apr 19, 2021

<sup>x</sup> *Dr. Jayanti Dharma Teja vs The State* on 6 July, 1971 (1972) CriLJ 127

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