



Shareholder Activism as a tool to prevent corporate fraud: A case study analysis of Punjab National Bank

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Abstract

A sound banking system is a fundamental prerequisite for the functioning of an economy. The Indian banking sector is developing rapidly and at the same time, it is also exposed to several obstacles. Recent frauds have proven that bank is exposed to several dangers such as embezzlement, failure to disclose the facts, falsification or fabrication of accounting records, corruption, etc. which has weakened the credibility of the financial system and posed a big challenge for the entire banking system. The world witnessed a lot of corporate fraud caused by CEOs and other top-level management authorities. After the Satyam Computers Ltd fraud case, several questions were raised on market integrity and the credibility of the management authorities. This incident made regulatory authorities implement corporate governance policy in the organization to prevent such kinds of fraud in the future. The role of corporate governance emerged to bring transparency and accountability in the working of audit committees and the duties of management authorities of the organization. Its mechanism is to monitor the activities of the organization and control the corporate actions. Monitoring and controlling of business organization should be done by shareholders of the organization. Shareholders possess a substantial interest and a great power in the decision-making, being owners of the organization, it is their responsibility to keep an eye on the functioning of the management of the company. The concept of active participation of shareholders in management decisions, monitoring their activities, and raising questions against the act of management executives whenever necessary, to bring desired change in the organization is known as 'Shareholder Activism'. If corporate governance is the legislative framework to ensure transparency and accountability of the management authorities, shareholder activism is the execution of this framework by active shareholders. To promote the practice of shareholder activism several regulatory authorities have supported it with laws such as the Companies Act 2013 and provisions of SEBI. Despite these laws, the practice of shareholder activism seems to be less. One such absence of shareholder activism can be noticed in the Punjab National Bank case.

Key words: Shareholder activism, PNB Fraud case, corporate fraud

Introduction

As per global estimates, the year 2019 witnessed economic slowdown. The giant economies such as China, Germany, USA and Japan were at recession mode. But during this period, Indian economy was growing and the reason being large consumption and investment capacity of Indian population. There was also rise in the flow of FDI in the economy and the initiative of ease of doing business provided the greater confidence to Indian as well the foreign investors. India due to its sound banking policies and practices has always outperformed on the global platform and recognized at global level for its banking practices. Even after having such strong banking system, the deadly scams in banking have shaken the entire banking industry. The scam which was executed in Punjab National Bank (PNB) is one of the biggest scams in banking sector.

Literature review:

- 1) Sagarika Mohanty and Sheela Agarwal (2021), "The Punjab National Bank (PNB) Scam Case study", considered that the PNB scam was biggest scam in entire banking industry in India and the major reason the case was falsification and fabrication of accounting records which was manipulation by the PNB's employees. As the employees could easily manipulate the accounting records it was considered that the banking system of PNB was very weak. Hence it was concluded that there is greater requirement of banking system of PNB and make employees to strictly abide by the laws of organization.
- 2) Dr. Media Srinivasa and Dr. B Kishore Babu (2020), "A Case study on Punjab National Bank Scam", argued in the paper that was the PNB scam is only scam or failure of entire banking system. Even after whistleblowers message was reached at Prime Minister's office warning the government regarding the biggest bank loot scam, no appropriate action was taken. Along with the mission Parivartan created the special team of PNB, it is required to implement Fugitive offenders act to prevent fraudulent activities
- 3) Vinay Jatav et al. (2022), "Financial analysis of public sector understanding: A case study of Punjab National Bank", considered that financial viability of the banking industry is certainly essential. It is required not only to uphill public confidence but also to make banks to perform their social responsibilities. The study has recommended that the financial efficiency plays significant role in promoting the new types of deposits and advance schemes.
- 4) Dr. Sushil Pande and Mr. Ved Prakash (2019), "Case Study on Scam in Indian banking industry", questioned the credibility of third party such as audit firm and the RBI for not being able to detect the fraud. Further the study mentioned that there were a lot of people were involved in this biggest bank loot scam. The study has recommended to evaluate the internal process of entire banking industry and take necessary action.
- 5) Gayathri S and M Thiagarajan (2018), "A critical analysis of the Punjab National bank scam and its implications", considered that PNB scam as the huge blow to the entire banking industry raising the questions on the internal safety and auditing process of financial firms. The study has found that it the inefficient auditing process and internal loop holes in the management caused for the scam.

Case Analysis

Punjab National bank which is the largest public sector nationalize bank, covering its operations in all over the world. In the 2017, this largest bank revealed a scam of Rs. 12700 crores, executed by one of the richest businessmen, Nirav Modi. He has the business of diamonds along with his uncle Mehul Choksi. He approached PNB for the buyer's credit to import diamonds from foreign countries. As per RBI guidelines the banks should demand for collateral securities against such buyer's credit wherein the two employees of PNB by manipulating the data issued the Letter of Undertaking (LOU) to Nirav Modi without taking any collateral securities. LOU is used by the importer to import the goods from foreign countries which is issued by the Indian bank. Using the LOU the importer gets loan from the Indian banks which are present in the foreign countries. In case if importer fails to repay the loan amount, the Indian bank which issued the LOU will be held default for the payment of loan. He had taken loan in different which started from the year 2011 to 2017. Any transactions held between Indian and foreign banks has to be through SWIFT system which was not linked to Core Banking System (CBS) in this case. All the transactions relating to issuing LOU must have been automatically recorded in CBS but as in this case as CBS was not linked with PNB SWIFT, the employees took advantage things were done manually in PNB Mumbai branch. They issued false LOU copies. When the companies of Nirav Modi tried for buyer's credit again, the officer asked for collateral securities. the company rejected to give collateral securities saying they have taken buyer's credit in the past 6 years without collateral securities. this made the officer suspicious to go through the records of issuance of buyer's credit to company and after verification the case was handed over to CBI.

Shareholder Activism and its significance:

Shareholder Activism is the act of monitoring the activities of the company by shareholders and raising voice over any misconduct of the company. The major hindrance for shareholder activism in this case is the bank is held majorly by promoter (74%). 17.2% institutional shareholders and 3.4% mutual funds and 4.8% FII hold the bank's stake. SEBI has provided significant provisions for minority shareholders. shareholders can submit their proposals in the Annual General Meeting, they can privately negotiate with the management regarding to bring change in the management and if required they can also communicate their views publicly with the help of media. At the more aggressive level they can sue the company against misconduct. The major question arise in this case is why major institutional shareholders of PNB such as LIC and mutual fund and other shareholders could not detect the falsification and fabrication in the accounting reports. Why the financial reports were not verified by these shareholders. This justifies that shareholders of the bank were not active.

Conclusion:

Shareholder activism can be used as one of the effective tools to prevent fraudulent activities in the companies. Even after the provisions of SEBI and the company act 2013, shareholders are failing to play active role in the companies they invest. Lesson has to be learnt from this case that it is also they duty of shareholders to keep an eye on the matters of the companies they invest. They have to play active role through which they can improve the corporate governance of the investee company and as well as safeguard their investment.

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