CRITICAL ANALYSIS OF INSIDER TRADING AND THE INDIAN LEGAL REGIME WITH SUGGESTIVE FRAMEWORK

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Abstract:

This Research Paper attempts to explain the concept of insider trading which is a known wrong practice followed in India. Insider Trading occurs when someone trades in the stock of a company by illegally getting access of the sensitive information of the said company. Such information could be for example, significant yet-to-implement significant merger or acquisition deal or any important diversification plan etc.

It is a menace because it lowers down the trust and confidence of common public to trade in the securities market due to unfair and unreasonable ways of trading which can even lead to massive market crash, resulting in huge financial losses; harming the reputation of market as a whole. This can lower the interests of the potential international investors.

India does have laws and regulations to prohibit insider trading in the country like the SEBI Regulations 2015. India also gives statutory powers now to SEBI to regulate and safeguard the rights of investors and others in the securities market. But all in vain because; either they lack implementation or are insufficient to curb such practice.

Some laws do consider this act of insider trading as an offence but there is no proper set up to provide the apt and speedy justice which is call of the hour. Our own judiciary already has a lot of pending cases and no timely disposal of them is just increasing the workload with no relief for the aggrieved.

Thus, this research paper attempts to give an overall analysis of ‘Insider Trading in India’, starting from its evolution. This evolution covers aspects like Recommendations of various important Committees, provision in Companies Act 1956, Companies Act 2013 and so on with various amendments (if applicable).

It further tries to explain and critically analyse adverse effects of it by studying some landmark case laws and scams and therefore tries to find solutions for the same so as to protect the investors and the company as a whole. This will ensure better and a more transparent trading system in the securities market which means more confidence among the many players especially the small investors i.e. the General public

Evolution of Insider Trading in India and Relevant Laws for It:

It was for the first time during the 1940s when concept of ‘Insider Trading’ was mentioned in India. It was under the Thomas Committee Report in 1948 which quoted few instances that occur in a company where strategic and important information of the

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1SEBI (Prohibition of Insider Trading) Regulations 2015
company gets possessed by people like the company’s agents or officers or auditors and such information is secretive and not for disclosure purpose - data about declaration of dividend, issue of bonus shares etc.

Soon this concept was recognized by law and in the year 1956 under the Companies Act under Sections 307 and 308 it got incorporated. Section 307 clearly provided for the need of maintaining of the registers by the company to keep a check on the shareholdings of the directors of the company while Section 308 imposed a duty on the directors and deemed-to-be-directors to make proper disclosures of their respective shareholding patterns.

This Companies Act3 was Amended in the year 1960 and the Provisions of the Sections 307 and 308 got applied to the Managers of the Company as well. Even after this Amendment, the main purpose to keep a check on activities was not applicable to other company’s agents.

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Later in the year 1979, the Sachar Committee5 found the above-said Sections 307 and 308 insufficient to keep a check on acts which involved insider trading so it suggested for some penalties to be imposed. It mentioned in its reports that in some cases; the company’s directors, auditors and company secretaries can have access to some price sensitive data which could have chances of manipulating the prices of the company’s stock in the market. They suggested to keep such information restricted and not to reach staff and employees of the company.

Then in the year 1986, the Patel Committee6 gave a definition to the term ‘insider trading’. According to the Committee, insider trading is the act of trading in stock and shares of a company by a person who is part of the management of the company or is closely related to the concerned company, with the help of some unpublished / not-to-be disclosed price sensitive information like which is related to the upcoming ways of operations of the company. This Committee also recommended some amendments to the existing Securities Contracts Act7 in such a way that it controls the practice of unfair trading methods and malpractice of insider trading. For example, it suggested that the Act under its Section 21 should permit the stock exchanges to make their own terms and conditions for restricting insider trading.

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3 The Companies Act 1956
4 The Companies Act 1956
5https://www.icsi.edu/media/portals/72/year%202018/presentation/ROLE%20PLAYED%20BY%20SEBI
6International Journal of Research- Granthaalayah 8 (9): 49-53
7Securities Contracts (Regulation) Act 1956
conditions for the purpose of the listing of the prescribed companies to it. The Committee also suggested for imposing of some strict penalties and fines to curb the practice of insider trading in the country.

Then was Abid Hussain Committee in the year 1989, which suggested for both civil and criminal proceedings against the person or people involved in the act of insider trading.

This Committee even recommended the Securities and Exchange Board of India (SEBI)) to make its own rules and regulations so as to prevent and reduce the unfair dealings of the securities in the concerned market. Some of the above-mentioned recommendations of the said various Committee were taken into consideration and soon in the year 1998, SEBI came into existence to protect the interests of the investors in the securities market. It got statutory in the year 1992 under the supervision of the Ministry of Finance and SEBI got its own Act in this year. Under the SEBI Act 1992, SEBI prohibits Insider Trading under the Section 12A and penalty is imposed under the Section 15G.

In 1992, came the SEBI (Insider Trading) Regulations which got recognized by the virtue of the Section 30 of the SEBI Act 1992. These Regulations were enforced to curb the fraudulent practices which were done to deal with securities in the market by creating provisions to convict the offenders. The provisions for such type of conviction can be found under the Sections 15G and 24 of the SEBI Act 1992. The 1992 Regulation got amended in the year 2002 on the basis of the recommendations of the Birla Committee along with the judicial decisions held in landmark cases of the Hindustan Lever Ltd v SEBI and Rakesh Aggarwal v SEBI. In the 2002, these new Regulations came to be known as ‘SEBI (Prohibition of Insider Trading) Regulations’. The Regulation 4 in it punishes the person guilty of being involved in insider trading, imprisonment for a period which may extend to one year or with fine or with both, as the case may be. This Regulation gets enforced after being applied with the Section 24 of the SEBI Act 1992. The 2002 Regulations got amended in the year 2015 and these Regulations are now known as the ‘SEBI (Prohibition of Insider Trading) Regulations 2015’.

The SEBI Act and Regulations today are preventive and punitive in nature so that the person with inside information prohibited from dealing in securities by wrongful means. Exception here being the cases of ‘Innocent Tippee, as discussed later in this Paper.

SEBI has powers of delegation, which means it can delegate an investigative authority its powers after it gets complaint of any director or investor or intermediary being indulged in the acts of insider trading. SEBI in general, is called as a ‘watchdog’ as it has powers to investigate into such matters on its own, even on the grounds of suspicion.

Since the concerned issue is about justice; the accused gets notice in advance of investigation for the purpose of fair hearing after which SEBI prepares a report on the

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9 (1998) 18 SCL 311 MOF
10 Final- Decided by the Securities Appellate Tribunal- November 01,2003
same. These issues can also lead to criminal prosecution, depending on the findings and decision of the said case.

Recently in the year 2013, Companies Act 2013 came up with the definition of ‘Insider Trading’ in the Section 195 which talks about ‘Unpublished Price Sensitive Information (UPSI)’ being possessed by the Directors or Key Personnel of the Company.\(^\text{11}\)

In the same year, the Sodhi Committee\(^\text{12}\) under the SEBI Panel recommended for the internal disclosures to be done by the promoters, employees, directors and their immediate relatives in the company. This Committee even suggested for a proper, clear and precise legal framework in the country to prohibit the insider trading within the companies in such a way that it is backed by the enforceability of the existing Laws and Regulations.

**‘Insider Trading’: and its Impact**

Generally, Insider Trading is a method by which some important or confidential information of a company gets leaked in such a way that it hampers the pricing of the securities of the said company. This data is not disclosed to general public, who wish to invest some part of money into the stocks of the company and is discussed solely by the company’s Board of Directors.

This discussion highly influences the decisions related to price of the company’s securities in the trading market. It is called ‘Insider Trading’ as it is assumed that such sensitive data could be shared only by some key personnel of the said company.

As per the SEBI Guidelines and Regulations\(^\text{13}\), this ‘insider’ person has some connection with the company for minimum past six months and has access to the company’s UPSI i.e., Unpublished Price Sensitive Information. Such ‘insider’ person could be anyone related closely to the company like legal counsel or auditor or director or employee.

- UPSI is defined under the SEBI (Prohibition of Insider Trading) Regulations 2015\(^\text{14}\). In brief; UPSI refers to any information which has some impact on the securities of a company; which is not otherwise available to general public.

The companies need to disclose only material facts related to the companies that it issues for the common people as well.

**As per these SEBI 2015 Regulations; communication of UPSI in any forms, shall be considered an offence, unless permission taken from the required Directors of the Company. Also, indulging in trading of securities while having any UPSI, is prohibited in India.**

It is ethically and morally unfair to do trading in the market with the help of such decisions which are restricted to Board of Directors only. Example for this, could be getting to know about a major takeover deal or change in the company structure or any other confidential financial data which needs not to be disclosed to the general public anytime sooner.

\(^\text{11}\) Companies (Amendment) Act 2017 (WEF 09 Feb2018)
\(^\text{12}\) SEBI PR No. 120/2013
\(^\text{13}\) SEBI (Insider Trading) (Amendment) Regulations 2002
\(^\text{14}\) Regulation 2 (1) (n)
Any information regarding the securities’ price which needs to be made public; will always be shared by the said company and if there is something that cannot be published then one should maintain its privacy.

SEBI earlier in past\(^{15}\), has held that if a person if found having UPSI and having similar securities of the stock market then it shall be presumed by the authorities that the concerned person that the said shares were availed because of the knowledge and awareness of the sensitive information in hand. But in April 2020; in one of its Orders\(^{16}\), SEBI Adjudication Orders of say, the SBI UPSI and other associated matters; has upheld the Concept of ‘Innocent Tippee’. This person is someone who proves that the benefits arising out of given shares were not due to handling of any sensitive data of the concerned company.

This proof can be granted on showing either both or one of the following-
- That the concerned that the matter was about to be made public or was so, already
- The information was known to a common but authorized broker entity

(The Defence of Innocent Tippee was even seen earlier in the Report of the NK Sodhi High Level Committee\(^{17}\))

While deciding various matters in March and April 2020; SEBI has now made it clear that if there is any information which is already disclosed in any kind of research-based report- being available to large number of investors in the market; would simply imply that such date has been made public. Even the SEBI has held that matters of UPSI being shown on any news channel in any form would also mean that this sharing of information is of public nature\(^{18}\). In April 2021 in the matter of Shruti Vora v SEBI\(^{19}\); the Securities Appellate Tribunal (SAT) held that some information or data can be termed as UPSI only when the accused knows that such vital fact is not published anywhere and was also aware that the concerned prices of the stocks are sensitive for the market players. The tribunal also held that the knowledge of the given information should be such that it can be established on basis of value of probabilities ongoing in the market.

Considering the gravity of cases, related to Insider Trading in the country; the SEBI in June 2021\(^{20}\), has increased the award amount for the whistle-blowers so that they have more encouragement to look into such matters. The reward has now increased from the initial Rs. 1 crore to now Rs. 10 crores for the whistle blower. This will help, to some extent, to reduce the number of insider trading cases in the country; thus, ensuring in fair trading in stock market.

In July 2021, SEBI held in the matter of Biocon Ltd Scrips \(^{21}\) that anyone who sells some or all shares and that too just before good announcement by the concerned company; would not lead to insider trading if

\(^{15}\) Under SEBI (Prohibition of Insider Trading) Regulations 1992
\(^{16}\) Aditya Birla Sunlife AMC Ltd Matter, SEBI Adjudication Order 2020
\(^{17}\) Year 2013
\(^{18}\) https://indiacorplaw.in/2020/05/research-reports-converting-upsi-into-public-information.html
\(^{19}\) Misc. Application No.346 of 2020 (Delay Application) and Appeal No. 308 of 2020
\(^{20}\) SEBI Whistle-blower Order, 2021
\(^{21}\) SEBI Final Order, WTM/AB/IVD/ID-3/06/2021-22, in the matter of Biotin Limited
found no undue advantages of the news were availed. SEBI also clarified that the offence of Insider Trading is both civil and criminal in nature so as to punish the wrongdoer.

In September 2021\textsuperscript{22}; Securities & Exchange Board of India (SEBI) had passed an Order to bar an Employee of Infosys and of Wipro to access the securities in the market. This was because they both were found to be involved in insider trading matter which was concerned with the shares of the Infosys. They had access to the Unpublished Price Sensitive Information (UPSI) which helped in trading with help of the scrip of Infosys in hand. The concerned two employees even got the insider announcement of Infosys getting into a strategic alliance with the Vanguard. SEBI did give an opportunity for defence reasons but it was not satisfactory. Then, an amount of around Rs. 2.62 crores were also impounded, which later got deposited by the 2 employees in December.

It is not the case that SEBI directly passes and Order or a direction against people alleged to be involved in offence of Insider Trading. In September 2021, for example, SEBI sent a show cause notice to all the 141 Employees of the Titan Company to present their case in which they were alleged to be involved in the company’s insider trading. Here, the SEBI even set up an enquiry to confirm the allegations and questions were asked with the management of the company to know more about the concerned staff.\textsuperscript{23}

In October 2021; in SEBI matter\textsuperscript{24}, SEBI charged the applicants on individual basis, as per SEBI (Settlement Proceedings) Regulations 2018. SEBI Order was against the CEO of India-bulls Ventures and his 4 relatives and they were directed to pay around Rs.5 crores with interest for allegedly doing insider trading in relation to the company.

The accused here had the possession of the UPSI of the company to such an extent that one of the charged ones had made profit by illegal means, worth Rs. 1.22 crores by unlawfully trading with the insider scrips of the said company. Also, a high-level advisory committee was set up to recommend how to settle the matter at the SEBI.

In December 2021, the SAT in the Deep Industries case\textsuperscript{25} defined an ‘insider’ as someone who is connected or someone who is having some unpublished information about the price of the stocks which are sensitive in nature. It also gave examples, like an insider being the Managing Director (MD) or say a Promoter of the Company in concern who holds some shares. Similar view can be seen in the 2019 decision of the SEBI in the matter of the Apollo Tri-coat Tubes Ltd\textsuperscript{26}. SEBI strictly interpreted that a Promoter will continue to be in its position till it holds more than 10% in the concerned company. This position is a designated one so it cannot be negotiated and thus, the code of conduct done by it will bind it, even in cases related to insider trading. SAT also stated, in matter of Deep Industries, that our current

\textsuperscript{22} SEBI Order dated 27 September 2021- Infosys Shares and WIPRO Case
\textsuperscript{23} SEBI Titan’s Insider Trading Case, December 2021
\textsuperscript{24}SEBI Final Order in the matter of India-bulls Ventures Ltd, WTM/AB/IVD/ID2//13652/2021-22
\textsuperscript{25}Deep Industries 2018 SEBI Insider Trading Scrip Matter, Decided in December 2021
\textsuperscript{26}In the Matter of SEBI- Apollo Tricoat Tubes Ltd-Decided on 15 October 2019
law already provides for every listed company or firm to disclose all the material information related to stocks and as when required by the Board of it.

Recently in January 2022; SEBI has started keeping a check on social media applications which are available easily on any smart phone applications like Telegram which allow users to form secret or closed groups where various investors can manipulate and misuse data related to stocks in market, leading to unlawful gains for some.

After analysing and understanding the issue with insider trading above, it can be said that it is a serious and a rising malpractice in the country; affecting the fair working models of the companies and one of them major reasons behind this is ineffective implementation of laws in the country and lack of awareness among the people.

The existing laws to reduce the number of insider trading cases in India is the SEBI (Prohibition of Insider Trading) Regulations 2015- Amended in the year 2018. The maximum fine or penalty which can be imposed for indulging or doing insider trading in any company is Rs. 25 crores or thrice of the number of profits made; minimum being Rs. 10 lakhs only as per the Regulation Number 15G. The biggest issue is that the offence of insider trading in the country still does not have a full-fledged surveillance system. There are no proper setups to look after the transactions being dealt with. There is no reverification of the persons involved while doing the transactions related to the stocks of the companies.

SEBI decides the matters of insider trading but the principles for deciding the case are circumstantial in nature and that is why the set of rules to check for evidence vary case to case. It is one of the greatest loopholes in the system. Lack of sufficient evidence is the easiest way to get discharged off with any allegations. Sharing of information nowadays has become so quick. One text or call just takes a few moments; making the process of spreading the confidential data of the companies more convenient. This communication cannot be traceable as phone-tap is not allowed. This shows the difficulty that SEBI has to face while looking for evidences against the accused. One of the other challenges that SEBI also faces that it is the only authority with powers to decide cases of insider trading. This means it is overburdened with cases leading to delayed orders and decisions along with rise in pendency of undecided cases in the country. Even if the matter gets decided; more or less the offender has to pay some money as a fine. This makes a general impression towards the common people that the offence of insider trading is not that serious in nature. There should be strict and proper penalty, maybe imprisonment for certain period, for doing this grave offence.

There is an urgent need to make everyone understand the gravity of the offence of insider trading and its repercussions. There are various hidden aspects associated with insider trading that the public does not know like manipulation of stock accounts of the company.

The common investors were totally devastated after the famous Harshad Mehta scam in

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27Schedule III of the SEBI (Listing Obligations and Disclosure Requirements)

28In SEBI Order against Share Tips- In SEBI Re Stock Recommendations Case- Decided on 12/01/2022
199229. This shows the lack of basic understanding among the people.

It is just not the people who need to be educated. There is also a need to train and make the staff at SEBI more expert in the field of company law. This might help them while dealing with the issues of insider trading more effectively. The companies also need to develop more rules for the employees so that the standards of morals and ethics are properly executed. There should be strict actions for the violators. This could be one of the ways to keep a check on the key managerial personnel who might get access to secretive and confidential data of the company which affects the prices of the company’s securities. The companies can also have a committee to enquire into matters of insider trading before it reaches the courts, for better explanations or better redressal systems. The system of code of conduct might raise questions when the company is the result of say some arrangement like merger or acquisition. This makes more difficult to assess the extent of the liability caused while doing the act of insider trading. India does not have any law to remove ambiguities in such cases and sadly, there is a rapid increase in the number of merger or acquisitions in the nation which is making the situation worse and not easy to control or handle- leading to chaos only. India does not have any law to remove ambiguities in such cases and sadly, there is a rapid increase in the number of merger or acquisitions in the nation which is making the situation worse and not easy to control or handle- leading to chaos only.

There is also a need for some international laws so that India can even take action against the foreigners who come to the nation to do wrong deeds with the prices of stocks in the market. Currently, there is no explicit law for it- lack of scope of extra territorial jurisdiction. Either ways, the laws to curb the insider trading, whether at domestic or global level; Indian laws do not mention the relevance of mens rea while doing such offence. Some incomplete offences have serious consequences too and, in this way, the guilty mind for even planning for insider trading should be punishable to some extent.

Therefore, it can be said that if insider trading practice is not further reduced in India, then it can lead to serious adverse effects. The economy will be impacted badly and also the economy can also incur losses if there is rise in unlawful acts; leading to sharp decline in the number of foreign investments. The integrity and the value of the stock market would be distorted. The goodwill of the alleged companies would be tarnished in the market. The trust and faith of investors in trading will also be at stake. Lack of understanding can make them take drastic steps. Overall, it can result into a big crash in the market operations.

Some Drawbacks in the Indian Legal Regime while Dealing with Insider Trading:

True that India does have good number of laws and policies to implement to control the practice of insider trading but in reality, it is all on-papers only. There is ineffective implementation and no continuous checks on this practice, as ideally it should be.

29Harshad S Mehta v CBI, 1992 (24) DRJ 392, Decided by the Delhi high Court
Also, all the regulations do mention some way or the other to curb insider trading but no law mentions about need for some expert to analyse and deal better with cases of insider trading.

There is no involvement of any technical experts to study the insider trading cases in-depth. The SEBI and other bodies do take up such matters but there always remains a possibility of missing out some crucial facts which could only be understood by some expert of that field.

The laws are not even up to date which could, for instance, involve new, advanced and modern ways to keep a check and surveillance on such kind of malpractices in the country which could actually give a real and on-time updates to the SEBI. SEBI, many at times, get late information on such incidents which just leads to missing out some significant issues concerned.

The judicial procedure to solve the insider trading cases has no uniformity. Every bench has its own setup to decide the matter. Many times, the cases are decided based on circumstantial evidences only which are in itself insufficient in nature. Examples of such evidences could be telephone records or transcripts; nothing concrete as such. While mentioning about the tapping of the calls; tapping of calls is something that cannot be easily accessed even by the SEBI due to the privacy concerns. This makes the whole process of investigation more complicated. Only SEBI has the most powers to deal with insider trading issues in the country. One authority with so many responsibilities just reduce the effectiveness and productivity. SEBI is getting over-burdened day-by-day and there is no solution to lessen its workload. The punishment for insider trading is mostly fines and, in some cases, it is imprisonment for the guilty and that too for a very short term like a year. Such meagre penalties create no fear in minds of the wrongdoers while doing such malpractices. Moreover, the people find it easy to do insider trading and get away with its consequences in no time.

All our laws in the country are more or less related to authorities based. There is no provision to take any private right of action by the aggrieved investors. The victim has no right to proceed with its case with any regular civil court in the nation. The investors only have no right to be actively involved when affected by any insider trading act in the securities market.

In this era of globalization and digitalization; India still does have no or almost insufficient laws to do trials for the accused who are foreign nationals or who do insider trading by digital means. No law in the country, related to insider trading, has extra-territorial application till date, which is too problematic and is the biggest loophole in the Indian legal regime. It creates the situation more difficult to punish the accused who has actually done the offence but cannot even be interrogated.

Not even a simple investigation is allowed against any foreigner who might be involved in the acts related to insider trading of any company. There are also no international treaties as such to deal with these kinds of matters. Today, most of the companies are multi-national and having no law to deal with foreign accused reflects the lacunae in our Indian system. This makes our legal system weak in eyes of the other countries and it, in some way, encourages the outsiders to do
anything anytime with no worry of bearing of the consequences of being part of insider trading acts outside the said territory.

**Conclusion with Remedies / Solutions:**
The above-mentioned loopholes could be just of all the existing problems in our Indian Legal System but it is essential to identify each and every issue in it so that solutions could be found and be worked upon timely.

There is a need to make the public at large, aware of what actually is insider trading and what are the consequences of its happening. Government and concerned authorities can take help of media or social media platforms to increase awareness of such matters. They need to even understand the penalties for doing such offence. There should be no scope of offender making excuse of unawareness at any time of prosecution. Even the rest of the masses, should be aware of what is wrong happening around them. One suggestion could be inclusion of some private right action group can help such people to take some step against the wrongdoer. One of the known examples of a country having such kind of law, can be seen in Malaysia. A fear should be created by imposing more strict and enforceable laws in the country, so that everyone in concern thinks twice before doing this offence in the country- One can refer to laws of Vietnam for this. Laws are needed in India to curb Insider Trading practice even by the foreign nationals and digital experts. For this, there need to be even specific International Treaties to deal with such issues.

It might be said that recently in 2019, came the SEBI Amendment whose primary focus was on the UPSI and digitalization aspects. But these Regulations are still not implemented to fully and lack enforceability in some areas. Also, it complicates the procedure more.

It requires the burden of proof on only senior top officials of the company. In this scenario, lies a possibility of the company’s main management only being involved in acts of insider trading or say, being corrupted in working, etc. there is no full-fledged system till date to keep a control on such professional misconduct in any said company. This breach of professional ethics led to big scams in the past and are still continuing till date.

There is a requirement at the national level that the powers of SEBI should be extended so that it can do investigation in insider trading related matters in any way it wants; freely with no restrictions. Checks on its powers can be continued but there should be less limitations on its powers so that SEBI can function more independently. One recommendation is to create more bodies like creation of some Special Courts, to deal with this subject so that SEBI workload gets reduced which help it to decide cases more effectively and a maybe some good hierarchy needs to be made to hear such cases in more efficient manner for speedy disposal.

There has to be exact time-frames defined to avoid justice being denied, especially for the existing investors and the potential ones. Protection of their rights should be highly prioritized. One can even recommend for some type of compensation for the ones who get affected by act of others being involved in insider trading or any similar act.

The management of the company should be on their own responsible for compliance of ethical and moral behaviour in their
organizations so that the dealing and trading of their company’s securities in the securities market are done in legal and just way. They should regularly and in frequent intervals, make sure that all tasks in the company are going in right direction. The management should set up some committees or departments within the company which does inquiry against the ones who are even assumed to be involved in insider trading and other unfair practices.

This will lead to a better reputation and more confidence in minds of investors towards the company. The management can also, appoint some in-house authority who acts like a watch dog and does surprise checks on various ongoing activities of the firm but such person needs to be impartial, independent and fair in its observations.

Just because management appointed it; it should not encourage wrong deeds being practiced by the management. There has to be a proper mechanism which is vigilant on the company’s actions as a whole.

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