
CORPORATE GOVERNANCE FAILURE IN IL&FS: A CRITICAL LEGAL ANALYSIS

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ABSTRACT

This paper explores the origins of the Infrastructure Leasing & Financial Services (IL&FS) crisis which threatened to become a domestic credit crisis by its mere size and extent had it not been for the timely intervention by the government. The collapse of Infrastructure Leasing & Financial Services (IL&FS) in 2018 shook the foundations of India's financial system. Once considered a trusted infrastructure financing giant, its sudden downfall exposed deep-rooted issues in corporate governance, regulatory oversight, and financial management. This article critically examines the causes behind the crisis, focusing on governance failures, weak regulatory mechanisms, and systemic risks. It also evaluates the legal framework and governmental response, highlighting lessons for strengthening transparency, accountability, and financial discipline in India's corporate sector.

Keywords: IL&FS, Corporate governance, Financial crisis, Regulatory failure, Legal accountability

Introduction

Corporate governance is often described as the backbone of a healthy corporate system. It ensures that companies are run transparently, ethically, and in the best interests of stakeholders. However, when governance mechanisms fail, the consequences can be severe—not only for a company but for the entire economy. (jain, 2018)

The IL&FS crisis is a classic example of such failure. What started as a liquidity issue soon turned into a full-blown financial crisis, exposing weaknesses in governance, auditing, and regulation. (varotttil, 2017) This article attempts to analyse the crisis in a simple and relatable manner while maintaining legal depth.

Backgrounds of IL&FS

Infrastructure Leasing & Financial Services (IL&FS) was established in 1987 as a major infrastructure development and finance company in India. Over time, it expanded into a complex group with more than 300 subsidiaries, associates, and joint ventures. It played a significant role in financing infrastructure projects such as roads, ports, and energy. (Infrastructure Leasing & Financial Services, Annual Report, 2017) Due to its strong institutional backing and reputation, it was considered a “too big to fail” entity.

However, beneath this strong image, financial stress had been building for years, hidden by complex corporate structures and weak disclosure practices.

Causes leading to crisis

The IL&FS crisis started when their operation started piling up to much debt due to their increasing short term obligation for their operations. As an infrastructure financing company the IL&FS needed a short term operations but in return from its holding assets and business operations were of longer maturity which leads to the trouble situation for deferring paybacks to the loans and their inter corporation leading. IL&FS financed its long term project using short term borrowing which resulting in its assets liability mismatch. The IL&FS has its higher debt to equity ratio of 18:4:1. Along with the repayment of defaults, IL&FS had mismanagement issue assets liability which caused the downfall of 32 years old business. (mishra, 2023)

Two of the subsidiaries of IL&FS facing difficulties for paying off the debts. Overall the IL&FS groups i.e its 24 direct subsidiaries 135 indirect subsidiaries, 6 joint ventures and 4 associate companies had a combined debt of RS. 91,000. IL&FS hadn't disclosed bad loans on its books for years despite a big part of its loan book having sourced. (Reserve Bank of India, Report on Trend and Progress of Banking in India , 2019)

Further, there was a **lack of transparency and proper disclosures**, as the financial statements did not accurately reflect the company's deteriorating condition. Important risks were either understated or delayed, preventing timely corrective action. Lastly, weak internal controls and ineffective risk management systems allowed these issues to grow unchecked.

The crisis was driven by a combination of:

- Excessive reliance on debt financing
- Poor financial and project management
- Complex and opaque corporate structure
- Failure of credit rating mechanisms
- Lack of transparency and disclosure
- Weak internal controls and risk oversight

Government role in the crisis

IL&FS crisis made a strong point in the position of the NBFCs in the financial system and point out of the lacking from the regulatory bodies. IL&FS also created a distrust environment in the capital market and impacted the performance of all the listed NBFCs and listed shareholders of those NBFCs. IL&FS 91,000 Crore default was too big to fail crisis as this will lead a series of ripple effect in the Indian financial system. (Report on Trend and Progress of Banking in India, 2019)

The crisis of IL&FS clearly reflects a serious breakdown in corporate governance, which played a central role in its downfall. At the heart of the issue was the **ineffectiveness of the board of directors**, including independent directors, who failed to actively question or

challenge the decisions of the management. Instead of acting as a watchdog, the board largely remained passive, allowing risky financial practices to continue unchecked. There was also a noticeable **lack of accountability among senior management**, (Infrastructure Leasing & Financial Services Financial Statements , 2016-2018) as key executives continued to take decisions that increased the company's financial exposure without facing timely scrutiny or consequences.

Regulatory and legal frame work

The crisis of IL&FS highlighted significant gaps in India's regulatory and legal framework, despite the existence of well-established laws and institutions. India has a comprehensive system governing corporate conduct, primarily under the Companies Act, 2013, along with regulatory oversight by bodies such as the Securities and Exchange Board of India and the Reserve Bank of India.

1. Companies Act, 2013

The Act mandates provisions for board independence, audit committees, and disclosure requirements. However, the IL&FS case highlights gaps in enforcement (companies act, 2013).

2. Role of SEBI

The Securities and Exchange Board of India (SEBI) is responsible for regulating listed entities and ensuring transparency. Its oversight mechanisms were found inadequate in detecting early warning signs. (SEBI, 2015)

3. Role of RBI

As a regulator of NBFCs, the Reserve Bank of India (RBI) failed to effectively monitor systemic risks posed by IL&FS (reserve bank of india act, 1934)

Impact of the IL&FS crisis

One of the most immediate impacts was the **liquidity crisis in the Non-Banking Financial Company (NBFC) sector**, as lenders and investors became cautious, reducing the flow of funds. This led to a credit squeeze, making it difficult for NBFCs to raise capital and continue

their operations smoothly. (Reserve Bank of India Financial Stability Report, 2019) Additionally, there was a **significant decline in investor confidence**, as stakeholders began questioning the reliability of credit ratings, corporate disclosures, and governance standards across the financial sector.

The crisis also had a noticeable effect on the **stock markets**, where panic reactions led to volatility and decline in the share prices of financial institutions. Moreover, it contributed to a **slowdown in infrastructure development**, since IL&FS was a key player in financing large infrastructure projects.

The key impacts of the crisis are as:

- Liquidity crunch in the NBFC sector
- Decline in investor and market confidence
- Increased volatility in stock markets
- Disruption in infrastructure financing and projects
- Broader economic slowdown
- Greater regulatory and governmental intervention

Conclusion and recommendation

The downfall of IL&FS serves as a wake-up call for India's corporate and financial sectors. It clearly demonstrates that even large and reputed institutions are not immune to collapse when governance fails. A strong legal framework alone is not enough—effective implementation, ethical leadership, and institutional accountability are equally important. (Organisation for Economic Co-operation and Development, Principles of Corporate Governance) The IL&FS crisis is not just a story of failure, but also an opportunity to build a more transparent and resilient financial system.

To address these issues and avoid recurrence, the recommendations can be considered as to Strengthening the corporate governance practices by ensuring truly independent and active boards that can effectively supervise management decisions. Enhancing regulatory oversight

through more proactive monitoring and early warning systems by authorities like the Securities and Exchange Board of India and the Reserve Bank of India. Improving transparency and disclosure standards so that companies provide accurate and timely financial information to stakeholders. Ensuring accountability of auditors and credit rating agencies through stricter regulations and penalties in cases of negligence or misrepresentation. Simplifying complex corporate structures to make monitoring and risk assessment easier and more effective. Developing robust risk management frameworks within companies to identify and address financial stress at an early stage. Strengthening coordination among regulatory bodies to avoid gaps and overlaps in supervision. (World Bank, Corporate Governance Framework Report, 2019)

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