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## The IL&FS Debacle: Unravelling Corporate Mismanagement and Systemic Risk in India's NBFC Sector

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*The 2018 collapse of infrastructure leasing and finance services exposed a crucial flaw in India's non-banking financial company NBFC sector, revealing a systematic risk from poor corporate governance and financial mismanagement. With a depth of approximately 91,000 crores, IL&FS defaulted on payments, triggering a liquidity crisis that reverberated across India's financial ecosystem. The study examines the crisis through the framework of the Companies Act 2013 and also highlights the violation of fiduciary duty under section 166, 177, fraudulent practices under section 447 and mismanagement addressed way government intervention under section 241, 242. The Insolvency of the Bankruptcy Code, 2016 a facilitated restructuring, yet gaps in early detection persisted. Auditor's failure to flag irregularities and inadequate NBFC oversight amplified the crisis, necessitating regulatory reforms. By 2025, recovery efforts yielded over 55,000 crores, but the episode underscored the need for robust governance, stringent fraud monitoring, and enhanced NBFC regulations to protect stakeholders and maintain economic stability. This case study offers an insight into preventing future corporate failures by addressing systematic Vulnerabilities in India's financial sector.*

**Keywords:** corporate governance, financial fraud, NBFC.

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## INTRODUCTION

The IL&FS was founded in 1987. Infrastructure leasing and financial services were the Linchpin in India's infrastructure financing, backed by institutions like Reservoir of India and HDFC, and UTI. Operating through over 300 subsidiaries, the company that aimed to build the infrastructure went into massive debt by 2018. The Infrastructure Leasing and Financial Services (IL&FS) had its crisis in 2018, which was one of the most significant corporate debacles, exposing vulnerabilities in corporate governance, financial fraud, and mismanagement, violating company law regulations, and all these resulted in the downfall of the IL&FS company. IL&FS is also systemically important to NBFC (Non-banking financial company).

The ongoing infrastructure financing, a wide array of subsidiaries, and relationships with the leading financial institutions make IL&FS vital to NBFCs. The NBFC, after its 2018 default, exposed the dark side of the spiraling NBFC growth, starting a liquidity crisis that would rock the economy, leading to tighter regulations that limit its operations, thus affecting the overall economy owing to its systemic importance and character that defines it as the kingmaker of the sector and the most powerful actor in the economy and the entire market space. This case study analyses the Downfall of the IL&FS through the lens of the Companies Act 2013, the Insolvency and Bankruptcy Code 2016, and some of the Securities and Exchange Board of India (SEBI) regulations, which will help us to understand the reason for this downfall clearly.

This case study dissects the IL and FC Debacle through key legal frameworks, including the Companies Act, 2013, which governs corporate duties and fraudulent penalties and mismanagement remedies and also talks about the Insolvency and Bankruptcy Code, 2016, and SEBI regulations played a crucial role in stabilising this crisis. The IL&FS case serves as a cautionary tale, urging reforms to prevent similar corporate collapses and protect stakeholders in an Interconnected economy.

## UNDERSTANDING THE FACTS AND BACKGROUND

Infrastructure Leasing and Financial Services (IL&FS) was founded in 1987 as a core investment company registered with the RBI. It was established by three financial institutions: the Reserve Bank of India, the Housing Development Finance Corporation

(HDFC), and the Unit Trust of India (UTI) to provide loans for infrastructure projects such as roads, bridges, power plants, urban utilities, highways, etc.

Over the decades, IL&FS aggressively expanded over 300 subsidiaries, joint ventures, and associate companies. The company appears to have 23 direct subsidiaries, 141 indirect subsidiaries, six joint ventures, and four associate companies. It is also called a giant company because some big companies within India and outside India hold a share in this company. Some are life insurance corporations (LIC), which account for 25.34% of the shareholding. Housing Development Finance Corporation (HDFC) is 9.02 %, State Bank of India (SBI) is 6.42 %, ORIX Corporation, a company based in Japan, holds 23.54%, and Abu Dhabi Investment Authority holds 12.56% of the shares in this company.<sup>1</sup> This company has projects in various sectors, including Transportation, Area Development, E-governance, Health Initiatives, Cluster development, Ports, power plants, Water management, Urban Infrastructure, Environment, education, and Tourism.

It also worked on significant infrastructure projects, including the Delhi-Nodia Toll Bridge, Chennai–Nashri Tunnel, and Gujarat International Finance Tec-City (GIFT).<sup>2</sup> Then, it funded various infrastructure development fields. In 2018, the company faced some issues with mismanagement and financial recklessness, which led to a debt of 91,000 crores (around \$ 13 billion), and everyone thought it was going great until it couldn't pay its debts.<sup>3</sup>

The main trouble started in 2018 when IL&FS ran out of cash to repay loans. It borrowed money for short periods but used it for projects that took years to make the money back and repay that debt, and it's like borrowing money from a friend to buy a house and promising to repay that money in a month or pay back fast when the money wouldn't come for ages. So here, the project got delayed, and IL&FS had no cash to cover its debts. It also borrowed more money to pay for every 1 rupee it owed; it owed 18 rupees, a risky mess that grew worse as it borrowed more to pay old loans. The people running it, including founder Ravi

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<sup>1</sup> 'Infrastructure Leasing & Financial Services Limited Equity Shareholding Pattern' (*Infrastructure Leasing & Financial Services Limited*, 31 March 2024) <<https://www.ilsindia.com/pdf/ILFS-Shareholding-March31-2024.pdf>> accessed 20 April 2025

<sup>2</sup> '7 Key Infrastructure Projects of Infrastructure Leasing and Financial Services' *Business Today* (08 October 2018) <<https://www.businesstoday.in/panorama/photo/7-key-infrastructure-projects-of-infrastructure-leasing-and-financial-services-5744-2018-10-08/3>> accessed 20 April 2025

<sup>3</sup> Serious Fraud Investigation Office, *Report on Investigation into the Affairs of IL&FS and Its Subsidiaries* (2019)

Parthasarathy, made terrible calls, hid losses, lent to failing projects, and even sent money to fake companies to fake profits. At the same time, the board didn't stop them.

Weak rules didn't help – IL&FS faced less scrutiny than banks, and credit rating companies gave it top marks even when it was shaky, fooling leaders. In mid-2018, the cracks showed one part couldn't repay Rs. 450 crores in June, the boss quit in July, and by September, it missed 1,500 crores in payments, sparking panic.<sup>4</sup> The government had to step in because IL&FS was too big a failure, connected to banks, mutual funds, and investors. In October 2018, it replaced the old board with a new one led by Uday Kotak, a respected banker, to fix things.

They started selling off parts of the company, aiming to recover 61,000 Crore, and by 2025, they've raised over 55,000 Crore, leading to action against old bosses and auditors like Deloitte and EY, who missed the mark. New rules come into play to watch shadow banks better and prevent repeats.<sup>5</sup> The IL&FS case matters for company law because it shows why honest leadership, truthful books, strong rules, and protection for everyone involved are crucial. When accompanied by these significant failures, it hurts workers, leaders, and India's growth. By IL&FS is recovering, build a story that warns why company law exists to stop greed and bad choices from crashing a business and everything around it.<sup>6</sup>

## IDENTIFICATION OF LEGAL ISSUES AND PROVISIONS AND CONNECTIVITY WITH COMPANY LAW

The IL&FS crisis raises several legal issues pertinent to the company law, including the following:

**Corporate Governance Failure:** Legal provision Section 166,<sup>7</sup> which talks about the duties of directors, as the board of directors failed to discharge their responsibilities properly with a lot of transparency and accountability, will be applicable. Section 177, Audit Committee, will

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<sup>4</sup> *Ibid*

<sup>5</sup> *Services Limited & Ors v Union of India* (2023) C.A. 299/2023

<sup>6</sup> C P Chandrasekhar and Jayati Ghosh, 'banking a serious threat in emerging markets?' *Business Line* (06 December 2021) <<https://www.thehindubusinessline.com/opinion/columns/c-p-chandrasekhar/is-shadow-banking-a-serious-threat-in-emerging-markets/article25656071.ece>> accessed 15 June 2025

<sup>7</sup> The Companies Act 2013, s 166

also be relevant as the audit committee did not detect or prevent fraudulent practices and breaches of fiduciary duties.<sup>8</sup>

**Oppression and Mismanagement:** Legal provisions sections 241 and 242 of the Companies Act, 2013 which talk about the Application to the tribunal of relief in case of oppression, etc. and also the power of the tribunal as the government's applications to the NCLT (National Company Law Tribunal alleged that IL&FS board had mismanagement prejudiced public interest, justifying the board's suspension.<sup>9</sup>

**Fraud and Auditor Accountability:** Section 447 of the Companies Act 2013 discusses the punishment for fraud, which applies to prosecuting directors and auditors involved in fraudulent activities. Section 140(5) of the Companies Act 2013 talks about allowing the removal of auditors relevant to actions against auditors who failed to detect the issues. Section 132 of the Companies Act 2013 discusses establishing the National Financial Reporting Authority (NFRA), essential for overseeing auditing practices.<sup>10</sup>

**Debt Restructuring and Financial Statements:** Section 230 of the Companies Act 2013 deals with the schemes of arrangement that are crucial for IL& FS's debt restructuring efforts. Section 134 deals with the financial statement and board reports relevant to transparency and disclosure issues.

## APPLICATION AND ANALYSIS OF LEGAL PRINCIPLES

This section examines how the legal provisions were applied to the IL&FS crisis and assesses their effectiveness, using case specifics to ground the analysis.

**Corporate Governance and Fiduciary Duties (Sections 166 and 177):** Under section 166, directors must act in good faith and in the company's best interests. And also, they should exercise their duties with due and reasonable care and skill. The IL&FS board, however, permitted unchecked growth and high leverage of a debt-to-equity ratio of 18.4:1, which is driven by short-term borrowings to fund long-term projects. So, the mismatch in the asset and liability, coupled with the evergreen of loans, reflected in a breach of fiduciary duty. The committee of directors is given the power to oversee the company's operations. Still, they

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<sup>8</sup> The Companies Act 2013, s 177

<sup>9</sup> The Companies Act 2013

<sup>10</sup> *Ibid*

failed to exercise due diligence, as evidenced by the SFIO's finding of personal enrichment by key officials. There was a lack of transparency and accountability, which directors should maintain. Also, under section 177, the auditors were responsible for detecting fraudulent activities. Still, they failed to do it and even breached their fiduciary duty. Because the earlier the problem is detected, the less effect it will have.

**Fraud and Scams (Section 447<sup>11</sup>, 130<sup>12</sup> and 212):<sup>13</sup>** The SFIO, empowered by Section 212, found out that IL&FS was doing dishonest things with the company, like moving Rs.2,270 crores around to fake a healthy balance sheet, giving Rs.94 crores to its promoters, and hiding Rs.411 crores in fake loan approvals, which led to legal action under Section 477<sup>14</sup>, as the rule that can put the people in jail for up to 10 years for fraud, while the NCLT used section 130 to check five years of the old record and prove these wrong, this worked well to catch the culprits after the mess was apparent, with arrests, in June 2019 under another law adding more punishment. But these rules didn't spot the cheating early. Nobody noticed until IL&FS couldn't pay its debts, showing they're weak at stopping fraud before it happens. Section 447 is strong for punishing, but without something like required fraud alerts, it only fixes things after the damage is done, so we need better ways to catch scams sooner.

**Oppression and Mismanagement (Sections 241 and 242):<sup>15</sup>** Section 241(2) lets the government ask the NCLT to step in because IL&FS was poorly managed, losing Rs. 2400 crores on bad loans and messing up Rs. 541 crores by borrowing short-term for the long-term projects, which led to section 242 kinking out the old board of directors and putting Uday Kotak in charge on 1 October 2018, after IL&FS couldn't pay Rs.1000 crores in short-term loans; this move kept IL&FS from crashing and saved the economy, showing the law can bend to fix big problems. But it cared more about the big picture than helping shareholders or lenders who got hurt, leaving small investors with losses and no unique fix, so while sections 241 and 242 were good at cleaning the mess, they didn't stop it from happening or help everyone affected, meaning we need better rules to catch mismanagement early.

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<sup>11</sup> The Companies Act 2013, s 130

<sup>12</sup> The Companies Act 2013, s 447

<sup>13</sup> The Companies Act 2013, s 212

<sup>14</sup> The Companies Act 2013, s 447

<sup>15</sup> The Companies Act 2013, ss 241- 242

**Auditor Accountability (Section: 143, 140(5) and 132):**<sup>16</sup> Section 143 says auditors must report cheating. Still, Deloitte and BSR missed the IL&FS's huge 18.4:1 debt-to-equity ratio and unchecked financial records, so the MCA asked for a five-year ban under section 140(5). The NFRA started a check under section 132, while section 130 let the NCLT look at old accounts to prove they messed up after defaults showed up. After the crisis, these actions punished the auditors for not warning about a debt that hit Rs. 99,354 crores. But this only happened after everything fell apart, showing section 143 depends too much on auditors doing their job right without forcing them to check things as they go, and through sections 140(5) and 132 are tough, they didn't stop the problem, so we need better rules to make auditors catch issues early and keep things under control.<sup>17</sup>

**Insolvency and Financial Distress (Companies Act 2013):** IL&FS's defaults – Rs. 450 crores to SIDBI and Rs. 1,000 crores in short-term loans – qualified for Section 7 IBC creditor-initiated insolvency. However, its systemic importance and 169 subsidiaries led the government to invoke Section 241(2) instead, avoiding liquidation. In contrast, Section 66 IBC targeted fraudulent trading like Rs. 541 crore tenure mismatches, supporting director liability probes, bolstered by the RBI's Rs. 36,000 crore infusion; this hybrid approach preserved stability, adapting flexibly where Section 7's rigidity faltered. Yet, avoiding IBC's creditor-focused process marginalised traditional resolution, revealing its limitations for complicated NBFCs.

## CONCLUSION

The infrastructure leasing and financial service limited (IL&FS) crisis, marked by a towering debt of Rs. 99,354 crores and a 2018 cascade of defaults 2018, stands as a stark reminder of the fragility within India's corporate framework. This case study looked at what happened – bad management, secret cheating, and broken rules, which pushed the IL&FS to the edge. The Companies Act 2013 had ways to deal with these problems after they happened, but it couldn't stop them from starting, and that's a big lesson worth considering.

The people running IL&FS didn't do their jobs right. Under section 166 of the Companies Act 2013, they were supposed to be careful, but they let risky things happen, like giving up Rs.

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<sup>16</sup> *Ibid*

<sup>17</sup> *Ibid*

1,922 crores to companies that couldn't pay back and hiding losses with Rs. 145 crores in tricky loans.

The extra eyes meant to watch them, set up by section 149,<sup>18</sup> quit instead of helping, and the group checking money under section 177 of the Companies Act 2013, missed a giant problem, an 18.4:1 debt-to-equity ratio in messy records. A court stepped in on 1 October 2018, under section 242,<sup>19</sup> kicked out the old board of directors and put Uday Kotak in charge, which fixed things a bit. But this only happened after everything went bad, showing the need to catch trouble early with stricter checks.

There was also cheating going on. A special investigation team, using Section 212 of the Companies Act, 2013, found IL&FS faked its books, moving Rs. 2,270 crores around to look good, giving Rs. 94 crores to its bosses, and lying about Rs. 411 crores in deals. Section 447 punished them, and section 130 dug up old records to prove it, but this only started after they couldn't pay the debt of Rs. 450 crores to SIDBI. The law worked to catch the cheats later, but it didn't see coming, so we need better ways to stop tricks like this, like making companies report suspicious stuff sooner.

IL&FS also messed up, losing Rs. 2400 Crores on bad loans because of careless choices. Section 241(2) let the government take over for everyone's sake, and section 242 brought in a new team to calm things down. It helped, but people who owned shares or lent the money didn't get much back, showing the rules fix the big mess, but not all the little hurts. Plus, IL&FS hid its problems, breaking section 134<sup>20</sup> and kept the good rating until defaults hit in August 2018, which tricked people trusting the company and messed up the market. The rules didn't catch this fast enough, so they need sharper teeth.

The accountant who was supposed to check everything under section 143<sup>21</sup> didn't notice infrastructure leasing and financial services troubles, and only after it all fell apart, did sections 140(5) and 132<sup>22</sup> step in to look at them, with section 130 proving they missed the mess. This late action shows we need accountants to check things as they happen, not just after. In the end, IL&FS, through the Companies Act, can punish and clean up, but it's weak

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<sup>18</sup> The Companies Act 2013, s 149

<sup>19</sup> The Companies Act 2013, s 242

<sup>20</sup> The Companies Act 2013, s 134

<sup>21</sup> The Companies Act 2013, s 143

<sup>22</sup> The Companies Act 2013



at stopping problems before they grow. Fixing these means more rigid management rules, better cheating traps, and quicker market protections, so companies like infrastructure leasing and financial services don't crash and hurt so many again.

**Some of the suggestions to avoid this type of problem are as Follows:**

**Bolster Governance Standards:** It mandates training for directors on a Fiduciary Relationship under section 166<sup>23</sup> and enforces an independent audit committee under section 177<sup>24</sup> with a regular external review to ensure accountability.

**Proactive Fraud Detection:** Revise Section 143<sup>25</sup> that requires auditors to report suspicious transactions quarterly, supported by the NFRA-led real-time monitoring under Section 132.<sup>26</sup>

**Strengthen NBFC Regulation:** RBI should cap NBFC debt-to-equity ratios and mandate stress testing to prevent asset-liabilities mismatches, while SEBI enforces transparent credit rating processes.

**Safeguard Stakeholders:** Amend Sections 241–242<sup>27</sup> to include a restitution mechanism for affected investors and creditors, enforce equitability recovery post-crisis.

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<sup>23</sup> The Companies Act 2013, s 166

<sup>24</sup> The Companies Act 2013, s 177

<sup>25</sup> The Companies Act 2013, s 143

<sup>26</sup> The Companies Act 2013, s 132

<sup>27</sup> The Companies Act 2013