COLLOQUIUM

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The Satyam Story: Many Questions and A Few Answers

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KEY WORDS

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INTRODUCTION

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The shocking resignation of Mr. B Ramalinga Raju, the Founder and Chairman of Satyam, on January 7, 2009, came as the climax of twenty-two days of drama that started on December 16, 2008, with the negative reaction of shareholders towards the proposed acquisition of Maytas Infrastructure (a family-owned company of Mr. Raju) for $1.6 billion.

On January 2, 2009, Mr. Raju disclosed to the stock exchange that his family had pledged all its shares held in its holding firm, SRSR Limited, to institutional lenders, following which, in the next two days, the share of the Raju family in Satyam fell from 8.6 per cent to 3.6 per cent. During the intervening period, three of the independent Directors at Satyam resigned. On January 7, Mr. Raju confessed to his crime and absolved all the top functionaries of Satyam stating that they had no clue as to what was being done by him to orchestrate the elaborate fraud. Mr. Raju's letter to the board stated that Satyam's balance sheet as on September 30, 2008, carried fictitious cash and a bank balance of Rs. 5,040 crore. In addition, it carried an equally made-up accrued interest of Rs. 376 crore. There was an understated liability of Rs. 1,230 crore and an over-stated debtors' position of Rs. 490 crore.

This corporate drama left the spectators, including the employees of Satyam, its investors and auditors, those working in the IT industry, outsourcing industries, regulators, Indian citizens, competitors of Indian IT industry, and all the well-wishers of India in a state of shock. Since then, much has been discussed and written, and actions have been taken to address the issue.

A case has been filed against Mr. Raju under relevant sections of the Indian Penal Code— conspiracy (sec. 120-B), criminal breach of trust (sec. 406), cheating (sec. 420),

DISCLAIMER: This Colloquium is based on information available at this time in the public domain pertaining to the Satyam case. It is intended to serve as an analytical framework for understanding the issues involved. It is not intended to portray the actions of any individual or individuals as right or wrong in the legal, business or any other sense.

forgery for cheating (sec. 468), and fraudulent cancellation of securities (sec. 477-a). The CBI has taken over the investigation and a multi-disciplinary investigation team has been formed. Mr. Ramalinga Raju, Mr. Rama Raju (brother of Mr. Ramalinga Raju), and the CFO of Satyam, Mr. Vadalmani Srinivas, continue to be behind bars. On January 26, 2009, it was reported that five boxes of original land documents of as many as 147 firms floated by the relatives of B Ramalinga Raju, were seized by the Andhra Pradesh police. Allegedly, these papers had been concealed with the knowledge of family members and the senior trusted advisors of Mr. Raju.

On January 25, 2009, the two senior partners at PricewaterhouseCoopers (PwC), Mr. Talluri Srinivas and Mr. S Gopalakrishnan, were questioned and were taken into custody for criminal conspiracy and cheating. This was the first time in the history of corporate India that Chartered Accountants had been held on account of flawed auditing. PwC has since been under the scanner. It first tried to hide under the confidentiality clause but later agreed that the audited accounts were false. Many questions have been asked about the auditors of PwC and doubts have been aired about their competence and integrity. The Institute of Chartered Accountants of India (ICAI), the body that regulates the chartered accounting profession in India, initiated investigation into the role played by PwC, on the very next day, after Mr. Raju's confession, based on information available in the public domain.

The unfolding of Mr. Raju's story has resulted in Satyam being stripped of the "Golden Peacock Award" given by the UK-based World Council for Corporate Governance for its excellence in Corporate Governance four months ago.

The Government of India formed a new board comprising Mr. Deepak Parekh, Chairman of HDFC; Mr. Kiran Karnik, former President of NASSCOM; and Mr. C Achuthan, Director at the National Stock Exchange, former Member of SEBI, and former Chairman of Securities Appellate Tribunal. On February 17, 2009, the news that two senior executives of Satyam had been asked to leave generated mixed reactions. Since then, several senior level employees have left or have been offered jobs by other IT companies. Mr. A S Murty, from within Satyam, was appointed as the company's new CEO. He wrote to all Satyamites on February 19, 2009, stating his plans for austerity measures and asking all of them to help in reducing the operational expenses wherever and whenever possible to get Satyam back on track. On January 22, 2009, Kiran Karnik made an announcement about the decision of two of reasonably large customers who had given notice and were leaving[1] while also informing that some new clients had joined. On the brighter side, the World Bank publicly announced that with the management having changed hands, they were open to lifting their eight-year old ban imposed in December, 2008,on using Satyam as a vendor.

Two law firms of the United Sates, Izard Nobel LLP and Vianale & Vianale LLP, have filed class action lawsuit in the US Courts against Satyam and its board members on behalf of the owners of the American Depository Receipts (ADRs) of Satyam between January 6, 2004 and January 6, 2009. Questions have been raised about the credibility of Indian service sector, the strength of Indian laws with respect to corporate governance, and the safety of investment in Indian companies.

The opposition party, the UPA, in January 2009, accused the Andhra Pradesh Government of having been a party to the massive fraud by Mr. Raju and thus urged for a fresh look at the contract awarded to the Nava Bharat Consortium. In July, 2008, the Nava Bharat Consortium had turned out to be the lowest bidder by quoting a "negative grant" of Rs 1,240 crore—which meant that it did not require a subsidy and would rather pay the government money for executing and running the project by raising funds from real estate along the metro route. Mr. E Sreedharan, Head of the Delhi Metro Rail Corporation Ltd., was dismissed as the Project Consultant by the Government of Andhra Pradesh for criticizing this concept and the deal.

The unfolding of Mr. Raju's story has resulted in Satyam being stripped of the "Golden Peacock Award" given by the UK-based World Council for Corporate Governance for its excellence in Corporate Governance four months ago. Almost ironically, Satyam has been con-

[1] http://www.onlineequitycalls.com/2009/01/two-satyam-clients-walk-how-easy-is-migration/

ferred an award for its "Talent Preparation Service" by the American Society for Training and Development as reported on February 1, 2009[2].

A plan has been unveiled for selecting a buyer for Satyam. Several firms including Spice and L&T have shown interest in buying Satyam. Though not directly reported, the general belief in the industry is that other IT companies in India and elsewhere offering similar services have gained by the losses of Satyam in terms of clients, and experienced and well-trained talent.

There are wider ranging implications of the Satyam fraud for the entire outsourcing industry. Customers who wish to outsource their work rely on SAS 70[3] reports prepared by auditors in order to attest to the financial controls over the outsourced operations. The apparent failure of Satyam's internal controls and its success in duping all authorities for seven long years may raise uncertainty regarding continued reliance on such reports. Similarly, the Satyam fiasco raises concerns for public-company filers regarding their compliance with Sarbanes-Oxley Act provisions pertaining to outsourced operations.[4]

Given the complexity and enormity of the issue, it is time for academics, practitioners, corporate regulators, auditors, and leaders to stop and think about what if any lessons can be learnt. We could only learn if we remain open and not get bogged down by anxieties, fears, anger, biases, or stereotypes. The need to continue to dialogue, share, discuss, and reflect becomes even more important at this time. This Colloquium is a step in that direction. Several perspectives have been invited to discuss various aspects of the Satyam fiasco.

"Never Waste a Crisis": Corporate Governance Reform After Satyam

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During the U S Presidential transition, Mr. Rahm Emanuel, President Obama's Chief of Staff, observed that it was important to "never waste a crisis." A genuine crisis permits an executive, or a community, to take bold, transformative action with maximum support and minimal objection. In my opinion, such a situation exists in India following the financial collapse of Satyam, and it calls for an authentic commitment from the business community to support essential reforms in corporate governance and ethics.

The collapse of Satyam is a tragedy for the company's many innocent investors, employees, and customers. As with the ethical failures of executives at Enron Corporation in 2001, or Bernard Madoff's global Ponzi scheme in 2008, the collapse of Satyam provokes emotional outrage and offends us at several levels. We are troubled by the financial damage to innocent parties, on one hand, and by the questions that are raised about the culture that generated such behaviour, on the other.

There is another troubling aspect to these cases. In each instance, we know that the orchestrators of the fraud did not act alone. There were accomplices who aided and abetted the master schemers in their devious work. Why did so many others participate in these plans? Was it the incentives, pressures to conform, charismatic leadership, or shared values that led others to cast their fate with the villains? As one reporter asked of Satyam, "How did B Ramalinga Raju, the Chairman of one of India's largest information technology companies, carry out the biggest financial fraud in this country's history? Appar-

[2] http://economictimes.indiatimes.com/Infotech/Software/US_organisation_to_award_Satyam_for_talent_training_programme/rssarticleshow/4059516.cms

[3] Statement on Auditing Standards (SAS) No. 70, *Service Organizations,* is a widely recognized auditing standard developed by the American Institute of Certified Public Accountants (AICPA), available at http://www.sas70.com/about.htm

[4] http://www.techworld.com.au/article/272984/satyam_fraud_has_ramifications_outsourcers?pp=2

ently, it does take a village."[5]

Governance Failures

The economic crisis that is afflicting the world economy provides further context for assessing the causes and consequences of Satyam's failure. The "irrational exuberance" that characterized what former U S President, George W Bush, aptly termed as the economic "party" for which we are now suffering a "hangover," was brought about by waves of poor decision making. According to behavioural experts, exaggerated risk tak- ing is characteristic of entrepreneurial decision makers whose appetite for risk (and reward) can lead to excessive placing of bets. The world has seen a lot of exaggerated risk taking in recent times.

But entrepreneurial decision makers cannot survive in large organizations without the complicity of others whose own decision making orientations serve to preserve, protect, and buffer the entrepreneurs from oversight and governance review. At Satyam, the complicity of other executives, external auditors, and possibly board members contributed to Mr. Raju's ability to perpetuate the fraud. While it remains unclear how many accomplices, and in what ways, served Mr. Raju's purpose, prosecutors will name the accomplices and seek penalties prescribed by law. But the question going forward is how to create preventive measures that will warn investors, regulators, and overseers against such "patterns of fraud."

The network of family relationships that Ramalinga Raju sought to promote until the very end reflected both the traditional and the new. Family enterprises are as old as human communities, and it is honourable for each generation to feel an obligation to arrange for the well-being of the next generation. In India, this tradition has contributed to the emergence of pyramid business groups. *The Economist* recently examined such groups in an article entitled, "Pharoah Capitalism."[6] Quoting from a study by Professor Tarun Khanna of Harvard Business School and Yishay Yafeh of the Hebrew University, a third of Indian firms in the 1990s belonged to wider business groups, controlled by wealthy families or corporate "promoters." These organizations are controlled by families whose investments are usually limited to 51 per cent of a core company which, in turn, owns 51 per cent of various other "second tier" firms. This levera-ging serves to combine two serious corporate governance problems: entrenched management and diffused ownership.

It is illuminating to think about Satyam's activities in this way. Entrenched management was supported by a board of directors that provided ineffective oversight of Mr. Raju's decision-making. The diffusion of public share ownership exacerbated the problem. Raju's holdings, and those of his family, constituted a block that immunized him, and his decisions, from accountability. Neither directors nor other shareholders learned of the fraud until it was too late. It was only when Raju sought shareholder approval for several proposed acquisitions that would benefit his children more than Satyam that shareholder outrage halted the self-dealing.

Every business enterprise depends on a critical balance of leadership, governance, accountability, and trust. (See Figure 1) We can see how the intricate interplay of leader personality (ego), organizational conditions, and institutional context contributed to the governance breakdown at Satyam. Sound corporate governance acts as a brake on the most extreme impulses of entrepreneurial leaders by imposing standards of accountability and transparency. When governance is undermined, accountability suffers and leaders are free to run amok, incurring more risk, defying disclosure, ignoring legal requirements, and placing personal agendas ahead of

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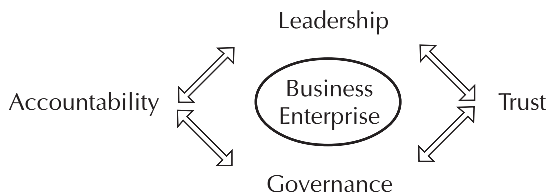
[5] Kahn, Jeremy (2000). "In India, Clues Unfold To a Fraud's Framework," *New York Times*, January 27, B1, 9

[6] "Pharoah Capitalism," *The Economist,* February 14, 2009, p.88.

the organization's interests. The ultimate business resource is trust, and leaders cannot be effective without it. Credibility depends on whether others trust them. That trust is earned, in turn, through accountability, transparency, and integrity.

Figure 1: Business Enterprise Rests on a Critical Balance of Assets



Like Riding a Tiger

The collapse of Satyam stands among an increasingly large field of corporate governance scandals that will be remembered by future generations. Amidst so many other scandals, Satyam is noteworthy for several reasons.

First, it is the largest financial fraud to have occurred in India. Other mega financial scandals have taken place in Europe, Japan, and the United States. We must ask what similarities exist across these cultural boundaries.

Second, Satyam operated within the framework of securities law and governance requirements in both India and the United States (it was registered on the New York Stock Exchange). How, we must ask, did the web of regulatory oversight in two countries fail to pick up signs of impending disaster? This leads, in turn, to the issue of what must be done to safeguard investors against future meltdowns.

Third, preliminary indications are that Satyam's fraudulent activities were enabled with assistance from its auditors at PricewaterhouseCoopers. The work of the auditing profession is to safeguard investors by affirming the essential facts of the business story. The Satyam case suggests that, at minimum, we must inquire as to what protection investors need from corrupted auditors?

These themes point to an important truth about financial scandals that have afflicted business during this decade: governance and ethics failures, such as Satyam, grow from a mix of individual, organizational, and institutional factors.

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The story of B Ramalinga Raju has been understood as one of hard work, great talent, and vision. Yet, in January, he wrote to the company's board of directors: "It is with deep regret, and tremendous burden that I am carrying on my conscience, that I would like to bring the following facts to your notice." He then explained the massive fraud that he had perpetrated on the board, Satyam investors, and the world. "What started as a marginal gap between actual operating profit and the one reflected in the books of accounts continued to grow over the years. It has attained unmanageable proportions as the size of company operations grew," he wrote. This disclosure is remarkable and points to the acute psychological burden afflicting Mr. Raju. Indeed, he says, "It was like riding a tiger, not knowing how to get off without being eaten."

Mr. Raju's fall from the heights of the global outsourcing industry parallels that of Bernard Madoff in the securities industry. The scale of accomplishment was so great, the trust of investors and employees so complete, and the business media approval so warm that Mr. Raju's admission of guilt (like Mr. Madoff's) shook those communities to their foundations. If Mr. Raju could perpetrate such a fraud, who is safe?

Bad Apple Theory

Could Mr. Raju's fraud be a case of one "bad apple" in the barrel? Or, is there something systemic in the barrel itself? Research from many quarters has pointed to the prevalence of "barrel" problems since Enron, WorldCom, and similar cases first appeared in 2001. Strikingly, a recent poll of young financial industry executives in London revealed that a majority believed morality was a "barrier" to personal success in business. Clearly, these "barrel" problems require serious attention by the business community.

The "barrel" in which Mr. Raju and others operated at Satyam surely had something to do with the scope and

extent of the fraudulent scheme. Outsourcing, like the securities industry, has some structural aspects that encourage fraudulent practices. It is a high growth industry with intense pressures on management to sustain that growth. Proper accounting for the amount and timing of fees requires management vigilance that is not always present. And there is always the temptation to pass along improper benefits to favourite customers. These challenges tempt many executives, though many do not succumb. Some live with a more reliable moral compass while others may fear legal enforcement. The regulatory and governance environment provides countervailing pressures that are always at play as the fatal attraction lures the "hero" toward his doom. Institutional factors such as enforcement practices are a crucial line of defence against entrepreneurial ego and outright greed.

Thoughts on Reform

The Satyam tragedy will have continuing repercussions for two reasons. First, the company has been a source of pride and a symbol of India's economic promise. It will be difficult to write the story of the nation's economic advances without reference to Satyam, a symbol of success, and now, India's "signature fraud."

Second, the economic era ahead will be challenging for companies because of the global economic crisis and the powerful role of governance failures in the underlying financial collapse. Lax corporate board oversight has been endemic in the US, Europe, and many other nations. India does not stand alone in this regard.

I believe, it will become clear that the scandals at Enron and WorldCom in 2001 were "capitalism's wake-up call" ignored. The failure to establish vigorous regulatory regimes, with effective enforcement powers, will stand as a clear marker in the evolution of the global crisis. "Capitalism's wake-up call" was ignored by presidents, legislatures, and business communities in nations across the globe. As a result, the years ahead will produce more burdensome enforcement processes to deal with "entrepreneuria-lism," corruption of auditor indepe- ndence, systemic risk, and personal greed.

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India must draw its own policy and regulatory lessons from the Satyam fiasco. One step that should be considered is the establishment of professional code of ethical conduct for all Indian enterprises. The development of such a code or system could force the discussion of ethical norms to become wider, broader, and more sophisticated in all enterprises. The more openly the topics of corruption and fraud are discussed, the more likely whistleblowers are to be encouraged and safeguarded.

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Public transparency is essential in the handling of the Satyam case. In retrospect, Enron and other cases provided an opportunity for business leaders to insist on sound governance and accountability practices. Instead, many invested more heavily in complaining about the cost and burden of the Sarbanes-Oxley law than they did in practising responsible capitalism. As Australian businessman, Noel Purcell, noted in a speech to fellow business members of the Caux Roundtable, "What is not widely understood is that Adam Smith described a system of 'enlightened self interest' and not one based on personal advantage at the expense of the common good… Societies function best, Smith argued, when economic and ethical interests coalesce."[7]

The crisis in global capitalism involves the failure of principle as well as policy. Economic

[7] Noel Purcell, "The Survival of Capitalism - Supporting Communities to Stare Down National and Global Threats," Presented to the Caux Roundtable, June 16-17, 2008. (www.caux.org)

and ethical interests have been on divergent pathways, as the Satyam case illustrates, for many years. "India's Enron," as it has been called, is an opportunity to rejoin economic interests and ethical interests through sound corporate governance and genuine accountability.

In Mr. Rahm Emanuel's words, this is a crisis that should not be wasted.

Satyam Fraud: The Regulatory Response

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When a fraud occurs at a large and high-profile company like Satyam, regulators need to respond decisively at three levels. First, they need to act swiftly to protect investors and other stakeholders in the company. Second, they should take steps to punish the guilty. Third, regulators must take proactive measures to prevent a loss of confidence in the governance of the corporate sector as a whole. How did Indian regulators fare on these three counts?

The disclosure of the fraud at Satyam coincided with a complete governance vacuum at the Company. Three weeks earlier, a shareholder revolt had forced the company to abandon a merger transaction that was a thinly disguised bailout of a company owned by the promoter family. By approving this related party transaction which provided little strategic or financial benefits to Satyam while draining its cash, the Satyam Board including its independent directors lost all their credibility. A week before the fraud, it was disclosed that the promoters had pledged their entire shareholding in Satyam and that all these shares had probably been sold by the lenders.

This governance vacuum effectively left the company in the laps of the regulators. The promoters were gone; and the independent directors who would normally take charge in a situation like this had no credibility left. It was easy to see that Satyam needed to be sold, but the problem was that somebody had to run the sale and do so quickly. If nothing were done, both clients and employees would have left in droves within days and there would have been nothing to sell. Moreover, Satyam was a large company with global visibility and global clients. These clients expected continuity of service, and failure to meet this expectation could affect the entire off-shoring model which had created so many jobs in India.

Satyam was a large company with global visibility and global clients. These clients expected continuity of service, and failure to meet this expectation could affect the entire off-shoring model which had created so many jobs in India.

There was no time for the shareholders to meet and elect a new board. There were only two choices. First, the existing board could have met for the sole purpose of co-opting a new set of directors and then the old board could have gracefully withdrawn from the scene. This was difficult because the potential incoming directors would have feared that the stigma of the old board would attach to them too and would have been reluctant to come on board.

The second option was for the government to invoke its statutory powers and seek judicial intervention. This is what the government did, and the Company Law Board (a quasi judicial body) passed an order for dismissing the old board and appointing a new board. This was a very creditable regulatory response to the Satyam fraud: a new board was put in place in less than a week and the worst was averted.

Thereafter, however, things have not gone too well. The government and the new board have tended to forget

that they are just a stopgap arrangement till the shareholders could decide on the future course of action. The board should either have convened a shareholder meeting to elect a new board, or put in place a transparent auction process that allowed the shareholders to choose between competing bidders.

The board and the government have instead acted as if they had complete control over Satyam and the shareholders were mere spectators. They have embarked on a path where the board proposes to decide on a strategic partner that would take a majority stake in the company. The regulator has also amended the takeover regulations in a manner that prevents competing bidders from bypassing the board and appealing directly to the shareholders. This, I believe, is a mistake. The board does not own the company; the shareholders do.

The decision of the board to sell a majority stake rather than the entire company also puts the board in the position of having to decide on the credentials of the various bidders. If the old shareholders were to sell all their shares to the bidder and go away, they could simply choose the highest bidder. Since they continue to own their shares, the crucial question is how well each of the competing bidders would manage the company after taking it over. Unfortunately, the board is arrogating to itself the right to make this judgement and the regulators seem to be endorsing and encouraging this usurpation.

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The board has also displayed little concern for transparency. I perfectly well understand that restating the accounts after a major fraud takes anywhere from six to twelve months. But a lot of information can and should be released sooner. Simple questions about the actual employee count and the true revenues have not been adequately answered. At a crunch, markets can value companies on the basis of revenue multiples and even enterprise value per employee. As it is, the market is left to pure guess work. There is talk of potential bidders being given more information, but that only begs the question of why investors are kept in the dark. The regulators have failed in their mandate to enforce greater transparency.

On the second level of regulatory response – punishing the guilty – the government moved quickly to arrest the key promoters. By contrast, in the United States, Madoff was allowed to stay at home weeks after confessing to a $50 billion fraud; he used this opportunity to divert some of his wealth to his friends and relatives. India seemed to be doing better. Unfortunately, after the initial success in arresting Mr. Raju, things have gone quite badly. There has been increasing scepticism about the progress of the investigation. For example, the securities regulator (SEBI) had to approach the Supreme Court to obtain permission to interrogate Mr. Raju after being stymied by the local police.

The third level at which a regulatory response was required was to deal with widespread fears that Satyam, far from being an unfortunate exception, was symptomatic of the problems that could be lurking in many other leading Indian companies. On January 7, 2009 (the day that the Satyam fraud was revealed), nine out of the fifty stocks in the S&P CNX Nifty Index fell by more than 10 per cent while the index itself fell by only 6 per cent. The median stock in the index fell by only 5 per cent while the median price decline of these nine stocks was 15 per cent. There was no industry pattern in these price declines; in fact, within the information technology industry itself to which Satyam belonged, some stocks with a reputation for above average corporate governance rose while some other stocks fell dramatically.

The market seemed to be responding to perceived governance problems in several of these stocks. Nor was this a one day flash in the pan; over coming days and weeks, these nine stocks extended their losses. By the end of February, while the index had fallen by 11 per cent and the median stock in the Nifty had fallen by 17 per cent from pre-Satyam levels, the median fall for the nine stocks was 37 per cent. In other words, the median of these nine stocks underperformed the index by a whopping 26 per cent. Only one of these nine stocks fell

less than the index; the other eight underperformed the index by margins ranging from 12 to 35 per cent.

Regulators needed to respond quickly and decisively to deal with this governance distrust. Regulatory reforms were needed to ensure that investors could have a modicum of faith in the audited accounts of India's largest companies. Within two days of the Satyam fraud, the regulators announced a one-time peer review of the working papers of auditors relating to the financial statements of a sample of large listed entities. This was a prompt and welcome response, but this has not been followed up by more enduring regulatory reforms.

A major fraud is an opportunity to push through important reforms which would otherwise be resisted by powerful vested interests. In my view, this opportunity was missed in India.

There are several reforms that could be undertaken easily and at short notice. For example, all companies could be required to publish detailed quarterly financial statements instead of the profit and loss summary that is mandated currently. India could also introduce a system of regulatory review of accounting statements on the lines of what is carried out by the US SEC. The oversight over the auditing profession could be enhanced by creating an independent statutory body for this purpose. But none of this has been done.

A major fraud is an opportunity to push through important reforms which would otherwise be resisted by powerful vested interests. In my view, this opportunity was missed in India. The initial regulatory response to the Satyam fraud was swift and appropriate, but this momentum was lost very quickly. Those who hoped for comprehensive and decisive reforms have been disappointed – at least so far.

Thoughts on Auditor Independence Post-Satyam

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Efficient capital markets depend upon firms to provide reliable reports about their economic performance. Since managers have incentives to distort these reports, investors and creditors, as well as other stakeholders, rely on external auditors to provide assurance that firms' financial reports are faithful representations of performance. Assurance audits are not a new business phenomenon; they have existed for centuries. Nonetheless, over the past few years, we have seen a number of major financial reporting scandals around the globe – including MCI Worldcom, Parmalat, Enron, and, most recently, Satyam – that have demonstrated that old though the audit process might be, we are still far from getting it right.

The issue in bad audits of large global companies is often not incompetent auditors. Large accounting firms make substantial investments in recruiting and training bright auditors and in developing appropriate audit procedures. Though auditors often claim that it is not their job to detect fraud, audit technology is always improving and in fact can be quite effective at fraud detection. The worrying issue is auditor independence, which has proven to be a problem in many large audit failures. If an auditor is not independent from the client, then he/she may fail to exert sufficient effort to detect a problem, or even after having discovered a problem, may fail to report it. In this essay, I review and evaluate some of the major steps that have been taken or considered in recent years to increase auditor independence.

Reputation, Litigation, and Regulation

The fundamental problem with the existing system of audits is that auditors are both engaged and paid by the same managers who may be responsible for misreporting. Auditors have incentives to comply with these managers in order to protect their fees. Still, there are factors

that work to keep auditors independent, in particular auditor reputation, litigation, and regulation. Auditor reputation is an important factor even in the absence of regulation. An auditor who is willing to accommodate a client who is cheating, stands to lose his reputation and with it his other customers. Litigation and regulation enforce good audits by imposing severe penalties on an errant auditor, and thus encouraging auditors to conduct good audits. The penalties for negligent or fraudulent audits include potentially impoveri- shing monetary penalties, restrictions on the ability to practice the profession, and even imprisonment.

Notwithstanding these potential costs of conducting independent audits, it is evident that many times audit firms and individual auditors turn a blind eye to blatantly fraudulent reporting on the part of their clients. Auditors have too often aligned their own interest with those of their clients. Clearly, in these cases, the monetary benefits to the auditor of colluding with the client have outweighed the expected costs of the collusion being detected.

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Steps to Increase Auditor Independence

In recent years, many steps have been taken to limit the economic benefits of collusion. For example, some countries have severely restricted the auditor's ability to provide non-audit services to the client. The fear is that the auditor's remuneration through non-audit services may be so large that the auditor may collude with the client on reporting issues. The empirical evidence on the efficacy of this restriction is mixed, and some studies suggest that an auditor who provides non-audit services to her client gains valuable client-specific expertise that can enhance an audit. However, there is no denying that non-audit services were a large source of income for auditors, and, for a while before the restriction came into effect, it seemed like non-audit services were the driving force in the international accounting firms.

Another potential threat to independence comes from the "revolving door." It has been a common practice for individual audit personnel to leave the firm and join the client. Potential employment creates an inducement for the individual to conduct a poor audit (while still with the auditing firm) and actual employment with the client puts the individual in a position to exploit weaknesses in the audit approach used by the accounting firm. In many major reporting fraud cases in the U S (Enron, Global Crossing, Waste Management), senior executives of the company were "alumni" of the firm's auditors. Following the Sarbanes-Oxley Act, a "cooling off period" was introduced in the US to bar the auditor from being employed with the client for a period of two years after leaving the audit firm, which should help to reduce the problem.

A strategy to increase audit independence that some countries have considered is mandatory rotation of audit firms. The European Union's ninth directive requires firms rotate their auditors every eight years. The argument for rotation is that as the auditor-client relationship lengthens over time, the marginal cost of conducting the audit decreases, and the net economic benefit to the auditor of retaining the client increases. Additionally, clients become more familiar with the auditor's procedures and can develop skills to circumvent these procedures. Rotation brings a new audit firm with more clear-eyed personnel and new procedures. Unfortunately, rotation necessarily means that the fresh auditor is inexperienced in the ways of the client. The empirical evidence seems to suggest that a client's reporting problems generally take place in the first few years after a new auditor is engaged, and that longer auditor tenure seems to result in better reporting. Perhaps a better alternative is imposing rotation of audit partners, as Sarbanes-Oxley does. The lead partner in the audit is required to be rotated after five years. This preserves the audit firm's expertise in the audit.

None of these remedies get to the heart of the problem – that auditors are paid by the very managers whom they are trying to monitor. One solution that has been proposed in recent year is that mandatory audits be scrapped in favour of mandatory financial statement insurance. If clients are required to obtain insurance for the correctness of their financial statements, then insurance companies will hire auditors to provide assurance.

Since the auditor will be engaged by the insurance company rather than the client, the auditor will not feel obliged to the client and, presumably, will conduct good and independent audits. While I see the benefits of having the auditor paid by someone other than the client, I am skeptical about this approach. The recent financial debacle on the Wall Street has shown us that investment bankers, monoline insurance companies, and rating agencies all effectively colluded in passing off poor quality mortgage-backed securities as relatively low-risk instruments. In the same way, it is not far-fetched to imagine that a client will collude with its insurance company and auditor to submit low-quality reports.

Following Satyam, there has been some discussion in India of requiring joint audits, as is required in France. The client is required to engage two auditors, who collaborate on the audit and provide a joint opinion. There is no evidence on the relative efficacy of joint audits. On the one hand, the idea that two pairs of eyes are better than one and that it is easier for managers to get one auditor to collude than to get two auditors to collude is appealing. However, it is possible that sharing the audit responsibility and allocating the audit effort means that no single auditor takes full responsibility for the audit. The jury is still out on joint audits.

National and global accounting firms, that are experts at internal control procedures, need to step up their own internal controls to minimize the chances that local partners are colluding with clients. In the same way, accounting associations, like the ICAI, which have largely focused on developing auditing standards, need to come up with procedures to "audit the auditors."

What Accountants Need to Do

In the end, it may well be that multiple steps need to be taken, not just by regulators but by auditors and associations of accountants. The large accounting firms, who are inevitably the auditor of choice for global companies, essentially operate like loosely affiliated offices. The ability of the national and global head offices to control what happens at the local firm office level is small. Local offices take advantage of the firm's technology, procedures, brand name, and global capabilities, but otherwise act autonomously. When a potential independence conflict arises, it is local costs and benefits that prevail in the trade-off – that is, the benefit to the local partners of being compliant to the client and the potential costs. National and global accounting firms, that are experts at internal control procedures, need to step up their own internal controls to minimize the chances that local partners are colluding with clients. In the same way, accounting associations, like the ICAI, which have largely focused on developing auditing standards, need to come up with procedures to "audit the auditors." If auditor independence violations can be limited, then it will go a long way to boosting the confidence of capital markets in the financial reports prepared by firms.

The Satyam Story: A Perspective from the Board Room

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I am writing this piece from the Board-room perspective, being in a company in the same sector as Satyam and someone who knew Mr. Raju and his family personally.

I was in the Quarterly Board Meeting of Mastek when I was called out, very unusually, and was given the news about Mr. Raju's resignation and attendant confession. The first reaction was that of shock and disbelief. Later,

as I got a copy of the letter and read and heard about the scam in detail, I was in denial. Being in the same industry and having the inside information of the cost structure of the business, I still think one would need to work really hard to not generate cash. Our business model in this industry allows us to grow on our own as retained earnings are sufficient to finance our growth and no external cash is needed for this purpose. In a way we fry the fish in the fish oil. However, I do not have access to the financial data from Satyam and thus cannot dispute or accept the theory of low profitability.

Fortunately, business has not been adversely affected by the Satyam incident. In fact, recession in the US economy has had a larger impact.

Another thing that surprised me was the admission that the Rajus held only 8 per cent stake in the business and even that had been hypothecated to lending institutions. Again, without ever having explicitly asked, I was under the impression that Mr. Raju and his family held a larger stake in the business (closer to 25 %). In retrospect, I do not know what led me to think that way, but such a low stake did surprise me. At another level, I am in a sense of disbelief. Having been in touch with Mr. Raju on a regular basis during professional meetings at NASSCOM and in other forums and also having spent time together with his family, I could not correlate the Mr. Raju that was being portrayed after the confession with the Raju that I knew and had interacted with on many occasions. In all my meetings and interactions with him over the last 10-15 years, I had never got an inkling that he was someone who was not above board. I had never felt that Mr. Raju was capable of the fraud that he had admittedly committed. Even as I write this piece, I feel a sense of loss at a personal level, bewildered because of the lack of clear understanding of the actual reason, and a sense of failure for being blind to this side of Mr. Raju.

Following the Satyam scam, at Mastek, active disclosures have been made to analysts about where our cash is, and about the fact that none of the promoters' shares are pledged. We did this voluntarily keeping with the tradition of being a very highly ranked company on corporate governance. We have actively communicated with all our clients and customers affirming that all is well on our front and also reassuring them that the Satyam case has been a one-off case. From our experience, the customers have been extremely understanding and have held their anxiety very well. At our quarterly employee meeting that we hold with all employees (which happened as per schedule), we have discussed and openly answered questions related to their concerns about the health of Mastek and also the aftermath of Satyam. The issue of communication with employees was discussed on the Board following which an appropriate message was put up on our internal web-site. On the other hand, the need to focus on communicating with our customers was stressed upon.

Fortunately, business has not been adversely affected by the Satyam incident. In fact, recession in the US economy has had a larger impact. Customers have continued their business with us and other Indian companies. Some of those customers who have migrated from Satyam have come to other Indian companies. It is not easy for any customer to switch between companies given the nature of the task-based relationship between the customer and the service provider IT Company. It is notable and indeed reassuring that customers have not moved to similar service providers in IT companies.

Several companies have come together to proactively respond to the possible backlash from the Satyam incident. Most large companies have informally decided not to poach from Satyam and thus not to fuel the exodus of trained workforce from Satyam.

Obviously, the IT services industry is not taking this reassurance of the customers complacently. Several companies have come together to proactively respond to the possible backlash from the Satyam incident. Most large companies have informally decided not to poach from Satyam and thus not to fuel the exodus of trained workforce from Satyam. A committee has been formed by NASSCOM to look into the corporate governance issues in the IT industry under the Chairmanship of Mr. Narayana Murthy of Infosys. The committee, composed of three or four of us from inside and a

few from outside the IT industry, will meet in March to clarify its mandate and get started on its agenda. NASSCOM has proactively sent a general statement to the IT Industry stakeholders at large to repose their trust on Indian IT service industry. The Executive Council of NASSCOM has had many meetings to brainstorm on what needs to be done at such an hour of crisis and shame.

As time has progressed, I have moved from the state of shock, denial, and anxiety to coping up with the situation. I have been a part of many NASSCOM meetings and discussions with colleagues at other companies. The coping up process for me includes helping colleagues at my company to make sense of the situation and also continue to engage with customers (existing and potential) about our credibility and be a part of the drive to keep the Indian IT service sector a preferred choice among outsourcers. As they say, when the going gets tough the tough get going. I am sure, we will be able to come out of this situation stronger and better!

The Satyam Saga – the Business Ethics Perspective

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In an article (2007) titled, "Business Ethics: The Next Frontier for Globalizing Indian Companies,"[7] the authors had argued that it is in the long-term interest of the globalizing Indian company to take a proactive posture on the ethics issue, rather than do nothing and just wait for the inevitable tightening of the regulatory screws.

The authors had recommended that globalizing Indian companies go beyond mere "compliance" with the regulations – by "creating an ethically sound working environment within the organization" and by "leadership at all levels setting an example for ethical behaviour." The authors had also emphasized the critical role to be played by the leader (the CEO) in "making ethics an integral part of the organization's culture."

The Satyam Imbroglio

Coming to the Satyam imbroglio, the findings of the various investigating agencies are yet to be made public. It would, therefore, not be proper to come to any definitive conclusions on what exactly was done by whom, and with what intent. This analysis, therefore, suffers from the limitation of insufficient information.

The only key document available in public domain is the letter dated January 7, 2009, written by Mr. Ramalinga Raju to the Board of Directors of Satyam Computer Services, in which he has talked about having inflated revenues, profits, and bank balances (among other things) over a long period of time. He has described his position as akin to "riding a tiger, not knowing how to get off without being eaten." He has also tried to justify the inflated and false figures on the plea that the company would otherwise have been taken over, thereby exposing the gap between reality and the reported figures – a classic example of circular logic, if nothing else.

The Business Ethics Perspective

What does the term "ethics" mean? The Markkula Center for Applied Ethics at Santa Clara University, USA, defines ethics as "*Standards of behavior that tell us how human beings* ***ought to act*** *in many situations in which they find themselves*" – as members of a family, citizens, businesspeople and so on.

The Center also lists what ethics is *not*:

- Ethics is not the same as feelings (of comfort or discomfort)
- Ethics is not religion (because ethics applies also to people who are not religious)
- Ethics is not just following the law (because law may have its own limitations)

[7] Seshadri, DVR; Raghavan, Achal and Hegde, Shobitha (2007). "Business Ethics: The Next Frontier for Globalizing Indian Companies," *Vikalpa*, July-September, 61-79.

- Ethics is not following culturally accepted norms (because norms vary)
- Ethics is not science (because something scientifically possible may not be ethical).

Our *Vedas* and scriptures offer abundant guidelines on how CEOs ought to conduct themselves. "Being free from greed," "looking after the interests of all stakeholders," and "following the path of righteousness" are values repeatedly mentioned in such guidelines.

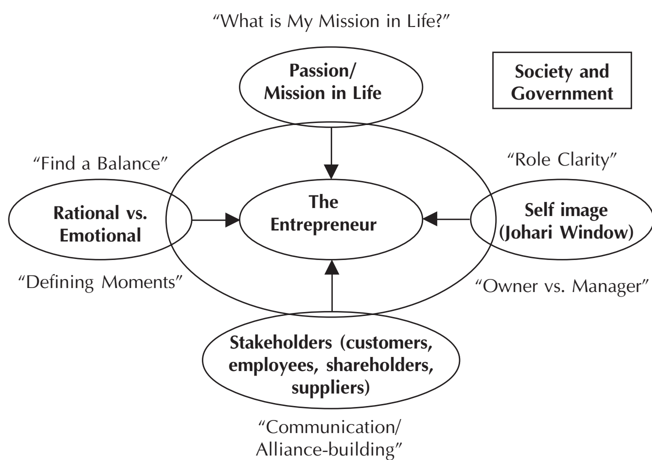
On the face of it, the Satyam imbroglio is a consequence of such basic values having been given the go-by by a small set of people in positions of great responsibility. Making a basic assumption that Mr. Raju's letter truthfully describes what he had done over the years, let us try to get some understanding on *why* he apparently took that path.

> Most individuals would like to think that they take decisions in a rational way; but the reality is that emotions tend to overrule rational thinking at times of pressure.

The Entrepreneur's Mind-map

We will use the model, "The Entrepreneur's Mind-Map" as a framework for this analysis (Figure 1). In this conceptual model, we see *decisions and actions taken by any entrepreneur to be the result of four powerful influences that are constantly working on him/her.* Depending on the influences that are more powerful at a particular point in time, or over a long period, the entrepreneur would be impelled to act in one manner or the other. This, in turn, has a positive or negative effect on the ethics of that particular decision or behaviour.

Figure 1: The Entrepreneur's Mind-map



A Model developed by Seshadri, DVR and Raghavan, Achal (2006)

The " Mind Map" as Applied to the Satyam Case

If we now apply this "Mind- Map" model to the Satyam case, the four powerful influences that were apparently at work on Mr. Raju take shape as follows:

- ***Passion/Mission in Life***: This is the over-arching long-term goal that drives the actions of the entrepreneur. In Mr. Raju's case, we could hypothesize that his mission in life was to be seen as one of India's most successful businessmen, having established from scratch a world-class business organization in the global IT services industry. Additionally, he possibly wanted to become one of the wealthiest business leaders in India. The relentless drive that he brought to the company over the years clearly signals his burning desire to be "the biggest and the best" in the eyes of the industry and public.

- ***Self-image***: This refers to how Mr. Raju saw himself and his role in Satyam. Was he the "owner" of the enterprise? Or did he see himself as a "manager" appointed by the shareholders to manage the resources of the company, make it grow, and generate profits? The contents of his letter dated January 7, 2009, to the Board indicate that he saw himself as the owner, rather than a manager. This, in spite of the fact that he and his family, along with trusts (collectively called "Promoter and Promoter Group"), owned only 8.74 per cent of the shareholding.

  This self-perception is not uncommon among entrepreneurs and their start-ups, which change later into broadly-held companies. The "baby" (the company) grows up, so to speak, and gets adopted by a group of guardians (the new shareholders) at the invitation of the "father" (the entrepreneur); but the father is unable (or unwilling) to acknowledge their presence or their role, or grant them their rights as guardians. In short, the entrepreneur wants sole control and "ownership" in perpetuity, regardless of financial and legal realities.

- ***Rational vs. Emotional***: This refers to the recurring dilemmas that the entrepreneur faces during the start-up and growth periods. Should he (or she) take decisions, by and large, in a rational manner? Or should emotions also be given a reasonable play? What is the "right" course of action when you are faced with a "defining moment" which can alter the course of your life or that of the company?

  Most individuals would like to think that they take decisions in a rational way; but the reality is that emotions tend to overrule rational thinking at times of pressure. Available information in the Satyam case indicates that Mr. Raju's decisions were, by and large, taken at the emotional level. The actions (and the logic for the actions) as described by Mr. Raju himself in his letter dated January 7, 2009, show events and emotions overtaking rational thinking. There is no way by which he could have otherwise assumed that all these actions would remain hidden from the public eye in the long term, or that he would be successful in achieving his intended goals without legal consequences.

- ***Stakeholders***: The entrepreneur is answerable to a multiplicity of stakeholders in the company, such as customers, employees, shareholders, and suppliers. The organization also has to exist in harmony with the Government and the laws of the land, as also society as a whole. This requires that the entrepreneur build strategic alliances with each of the stakeholders, through a process of continuous communication.

Ethical issues in corporate behaviour, such as in the Satyam case, are not necessarily fully explained by simple conclusions such as "greed" or "lack of a moral compass."

  In the case of Satyam, Mr. Raju seems to have been quite successful and effective in managing these alliances with the stakeholders for a long period. However, these communications and alliances were based on an increasingly shaky foundation – the financial performance of the company, and the increasing gap between the reported figures and reality. If anything, Mr. Raju had apparently convinced himself that he could continue with this make-believe success story indefinitely, and keep the stakeholders happy. In the end, however, he seems to have realized that he did not know how to "get off the tiger," and decided to go public with his *mea culpa*.

Conclusion

The above analysis, based on the scant information that is currently available, seeks to show that ethical issues in corporate behaviour, such as in the Satyam case, are not necessarily fully explained by simple conclusions such as "greed" or "lack of a moral compass." Many more complex forces, as outlined by the "mind-map" model, are likely to have played a part. We will have to await the results of the investigations to know the full story.

Beyond Leader, Lies Leadership: The Satyam Story

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Few topics in management literature have flourished as dramatically as leadership. The role of a CEO has been glamourized to such an extent that management has now become passé. Today everyone is striving to be a leader. The CEO has been attributed with a disproportionate amount of organizational success. The analysts who use only financial performance of an organization as the yardstick to determine profitability and performance, have contributed to a tsunami of corporate scandals in the last decade. In some cases, greed, unrealistic aspiration, and moral failure of the CEOs have led to their downfall. The dark side of such leaders is often not visible to the followers and by the time it is noticed, it is too late. Satyam is one such case

of moral failure of a leader. The case, however, provides both researchers and practitioners of management a framework to examine the distinction between a leader and a manager.

The fact that a number of bidders have expressed interest in buying Satyam is a confirmation of Satyam's competence that these organizations still value.

John Kotter,[8] a leading management thinker, introduced the distinction between a leader and a manager. In his description, a manager is one who provides control and solves problems and is involved with planning budgeting, organizing, and staffing. A leader is one who sets direction, involves people, and provides motivation. Unless each and every manager at Satyam had behaved as a "strong real manager" over the last two months of the crisis, today there would not have been buyers interested in the company. The fact that a number of bidders have expressed interest in buying Satyam is a confirmation of Satyam's competence that these organizations still value.

In the software services industry, the human capital is the most valued asset and people are the source of competitive advantage for organizations. The productivity and tacit knowledge of the employees make it difficult for competition to imitate service delivery. This unique capability of an organization cannot be built quickly. It requires long years of investment in people, systems, and processes. How did Satyam manage to do this? For those of us who have tracked the human capital and talent management practices in the software services industry, Satyam has had a long history of investing in its people. Since 2002, the company has consistently featured in the list of employers of choice and among the great places to work in. Training has been a key focus area at Satyam and with a strong and credible training team in place, a number of innovations have been attempted over the last few years. Besides, with a strong recruitment process and a culture focused on delivery, Satyam has emerged among the top five vendors from India. All this has been possible primarily due to the willingness to experiment with innovations in HR systems, processes, and procedures. This investment appears to have paid off for the company during its difficult times.

Internal communication within the organization must have been extremely effective so as not to perpetuate anxiety among the employees. The initial apprehension among employees and resumès filling up the job sites were indeed knee-jerk reactions from employees who were bewildered by the turn of events.

Amidst all the uncertainty and difficulty, the employees of Satyam have demonstrated a very high degree of decorum, dignity, and respectability. They have exercised restraint and caution in the manner in which they have engaged with the media. Informal conversations with employees give one an indication of the organization's strength and resilience. It appears that senior leaders in the organization have instructed the employees to retain their focus and meet and exceed customer expectations. The message communicated across the organization, in particular to the young recruits, has conveyed in clear terms that whatever was happening in the organization would not have any serious impact at their levels. Therefore, they need to concentrate on the task on hand which is to have satisfied customers. While not much is known at this stage, one would like to conjecture that the internal communication within the organization must have been extremely effective so as not to perpetuate anxiety among the employees. The initial apprehension among employees and resumès filling up the job sites were indeed knee-jerk reactions from employees who were bewildered by the turn of events. In such situations of organizational turbulence, where there is a tremendous scope for rumours, the manner in which the employees have conducted themselves calls for an in-depth examination of the case. This could provide a source of significant learning not only for corporate India but also for the global organizations.

O' Conner and Day[9] mention that "given the complex-

[8] Kotter J P (2001). "What Leaders Really Do?" *Harvard Business Review,* December, 1-10.

ity of challenges facing organizations, it is critical that all employees shift how they think about leadership and their role within it. They must move from seeing themselves as independent actors to seeing themselves as an interdependent collective whose purpose is to provide leadership when and where the organization requires it. Attempting to understand and practice leadership solely as something that individuals in positions of authority do, ignores the broader context within which leadership occurs. It ignores the interaction effect of all who participate in leadership, and the shared beliefs that drive those interactions." This conceptualization of leadership as a "collective capacity" is relevant in the case of Satyam. One could argue that a crisis of the magnitude that Satyam is experiencing has forced the mindset of a "collective leadership" process within the organization.

A crisis of the magnitude that Satyam is experiencing has forced the mindset of a "collective leadership" process within the organization.

Crisis tests the character of both the individual and the organization. It brings out the best and the worst in both. It also inspires people to perform great acts of bravery, discover their own potential, well beyond the capacity of the human thought process. It forces people to be creative, think out-of-the-box, engage, listen, and experiment. It forces an organization to become agile, take risks, and be innovative. The impact of the crisis at Satyam, both on the organization and its employees, would be visible over the next decade.

The discourse on Satyam has been dominated by the corporate governance perspective. The human and organizational aspects have been overshadowed completely. While corporate India, regulators, independent directors, and the Government examine the case thoroughly, and arrive at their own conclusions, what is noteworthy is that the employees of Satyam today are "ordinary people doing their ordinary work in an extraordinary situation."

Satyam – A Wake up Call for India Inc.

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'Satyam' seems to have transitioned from being a common noun (meaning truth in Hindi) to becoming a proper noun (the leading company) to a verb, and an adjective representing a fraud of a huge scale.

The Story Till Now – Act I, Scene I

The brief story till now has been as follows. Satyam, one of the leading software and Business Process Outsourcing (BPO) companies of India, declared after market closure on December 16, that it was planning to buy large stakes (100% and 51%) in two promoter-owned companies. The two companies, Maytas Properties and Maytas Infrastructure (the word Maytas is Satyam written backwards), are promoted by the family of the Executive Chairman of Satyam, Ramalinga Raju. The latter is a listed company. In a remarkably noisy protest against the move by investors, including the usually sleepy mutual funds, perhaps for the first time in the history of corporate India, a reversal of the perverted decision occurred within 24 hours of the announcement. While the combined valuation of $ 1.6 billion for the property and infrastructure companies sounded astronomical, given the steep fall in real estate prices over the past few months and the further expected fall over the next few months, the so called synergies between the three firms

[9] O'Conner P M G and Day D V (2007). "Shifting the Emphasis of Leadership Development: From "ME" to "All of Us" in Conger J A and Riggio R E (Eds) *The Practice of Leadership: Developing the Next Generation of Leaders,* San Francisco CA: Jossey-Bass, 64-86.

took the cake in terms of comic fiction. Given the disturbing transaction between the company and its promoter-related companies and the press release clearly calling it a unanimous decision of the Board, the finger naturally pointed towards the independent directors, whose job is to align the interests of the investors with those of the company.

The press release of December 16, clearly stated: 'Its Board of Directors has approved the proposals to acquire 100 per cent stake in Maytas Properties and 51 per cent in Maytas Infra.' It further affirmed that the acquisition of Maytas Properties would be immediate at $1.3 billion and the acquisition of Maytas Infra would be approximately 0.3 billion (because of the uncertain price which would apply to a takeover offer as mandated by law). This certainty of transaction and price are important as some of the independent directors would subsequently try to weasel away from the decision stating that it was contingent upon a valuation being done. Till this point, all evidence led to a gruesome violation of the fiduciary duties of the directors of this company, rather than an outright fraud. This view was enhanced by the release of the minutes of the meeting much later which showed not just what was going on, but also a more deliberate attempt at asking some of the right questions and being satisfied by whatever silly answers came their way. The independent directors of Satyam were clearly well-fed at Satyam (see chart).

The other body which clearly did not perform the task presented to it was a committee of the Board, known as the Audit Committee. This committee is mandated by the listing agreement of the stock exchanges and violating this 'agreement' can have serious consequences under the law. The functions of Satyam's Audit Committee included "Oversight of the company's financial reporting process and disclosure of financial information to ensure that the financial statements are correct, sufficient and credible," and "Reviewing with the management, performance of statutory and internal auditors, and adequacy of the internal control systems."

With the spending of the entire cash reserves of the company on a related party transaction by the company at a gross overvaluation— both internal audit and internal control issues would need to be studied. It is now clear that the committee did nothing, as the proposal came up directly before the Board. The committee grossly failed on these counts, whether by omission or by commission.

Prof. Krishna G Palepu (non-independent but non-executive member) (Harvard Business School)
Compensation: Rs. 91,91,000 + 5,000 shares sold at nominal value of Rs. 2 each of market price of over Rs.500. In addition, a large consultancy fee was paid to Mr. Palepu.

Mr. Vinod K Dham (innovator)
Compensation: 12,40,000 + 5,000 shares sold at nominal value of Rs. 2 each of market price of over Rs.500.

Prof. M Rammohan Rao (Dean, Indian School of Business)
Compensation: 13,20,000 + 10,000 shares sold at nominal value of Rs. 2 each of market price of over Rs.500.

Mr. V P Rama Rao
Compensation: 1,00,000 + 10,000 shares sold at nominal value of Rs. 2 each of market price of over Rs.500.

Dr. (Mrs.) Mangalam Srinivasan
Compensation: 12,80,000 + 5,000 shares sold at nominal value of Rs. 2 each of market price of over Rs.500.

Mr. T R Prasad
Compensation: Rs. 12,53,333 + 10,000 shares sold at nominal value of Rs. 2 each of market price of over Rs.500.

Prof. V S Raju
Compensation: Rs. 12,53,333 + 10,000 shares sold at nominal value of Rs. 2 each of market price of over Rs.500.

Source: Company Annual Report, 2008

Subsequently, other skeletons started tumbling out of the closet. First, of the so-called 6,800 acres of 'land bank' (land under development) by Maytas Properties and valued at $ 1.3 billion, only 100 acres could be verified. Second, the promoters of Maytas Infrastructure owned not 35 per cent of the company but closer to 85 per cent of the company as revealed by CNBC, a business channel. While the promoter holding was shown at around 36.6 per cent, many questionable names appeared in the public shareholding list. These shareholders, holding more than 40 per cent in the company, had been issued equity shares pre-IPO at a price lower than the issue price. Thus promoters were holding as much as 85 per cent in one of the companies sought to be bought by Satyam, though stated to be owned by them only to the extent of 35 per cent. Third, while a lawsuit in Texas, US, seeking over a billion dollars in compensation and also punitive damages, was initiated in 2007, it had not been reported to the Indian exchanges or to the SEC. This is a serious non-disclosure of material facts even though it is only of a contingent liability. Further developments including losing an offshoot case in London

was also not reported. This violated both the SEC regulations and the Indian listing agreement on disclosure obligations. Fourth, the World Bank had blacklisted Satyam from working with the Bank for a period of eight years for providing "improper benefits to bank staff," a euphemism for bribery. The Bank was apparently the fourth largest client of Satyam. Even this was not reported in mandatory disclosures across borders. The non-disclosure by the Bank also reflects very poorly on the transparency of the Bank which has been preaching nations about the benefits of transparency and governance.

Act I Scene II

Three weeks after the above story and the other revelations, Ramalinga Raju, the main promoter, 'confessed' to committing a major fraud on the company. He claimed that over several years, he had been inflating revenues and profits while understating liabilities and that he became addi-cted to the lies to keep up with the analysts' expectations. He also said that the proposed acquisition of the two Maytas sister companies was an attempt to whitewash the inflated numbers. While most of the media has taken the confession letter as containing the broad truth, after all a voluntary disclosure of fraud cannot be so unbelievable; it clearly hides more than it reveals. The only thing that is certain is that Raju has made at least the quoted amount of money vanish from the once venerable quartet of India's software giants. How he did this and with whose complicity is not clear, though he maintains in the letter that he was alone in this fraud.

> While most of the media has taken the confession letter as containing the broad truth, after all a voluntary disclosure of fraud cannot be so unbelievable; it clearly hides more than it reveals.

A quick back-of-the-envelope analysis shows that – if his letter is to be believed – in the second quarter of 2008, Satyam made an operating profit of Rs. 610m ($12.5m); given 53,000 employees, each employee would have earned an operating profit of $3.75 per day. This number stretches credulity by a wide margin. The confession story does not add up and the facts do not really exhibit internal consistency. In addition, it was not just profit figures, but hard cash which was missing. In a corporate fraud, that is one thing which is very difficult to manipulate, and it was clearly achieved. So it is more likely that the money was stolen rather than inflated. What makes this fraud most surprising is the level of checks and balances which were imposed by two jurisdictions on Satyam. As a company listed on the Indian and the US markets, Satyam complied with all the Indian norms on corporate governance and most of the American corporate governance requirements. The company had a Big Four auditing company going through its audit function. It had its accounts with reputed banks and a majority of directors as independent and marquee names to top it, e.g., a Harvard Business School professor specializing in corporate governance. It had won international awards for corporate governance and probably did an excellent job in a tick mark form of corporate governance checklist. Besides, it did not even have a dominant shareholder with a large stake—the promoter stake was in the range of 8 per cent all of which was pledged.

With a whole alphabet soup of investigators and regulators including the securities regulator SEBI, exchanges, Ministry of Corporate Affairs, the Serious Frauds Investigation Office, Finance Ministry, police, the US regulator, attempting to unravel the mess, it may be some time before an accurate picture of what occurred comes out in public domain.

Lessons for Corporate India

One of the scourges of India's corporate landscape is the existence of related party transactions and private investment holding companies. These will need to be reduced if not eliminated in the larger companies, for them to gain the trust of increasingly suspicious international investors. It is common for control persons to own shares of listed companies through private companies and trusts.

Also, the system by which independent directors are appointed and compensated will have to be examined carefully so that they are neither fiduciaries of the promoters nor so cosy with the management that they sleep through board meetings. The Audit Committee which has an important task of asking the right questions from the internal/external auditors and the Chief Financial Officer, free from the presence of management, will need to be held accountable. The mythical creatures called

independent directors will also need to face the music if they are unable to demonstrate independence. This can best be ensured if the minutes of the board meetings and audit committee meetings are released in full detail after a cooling off period of say, one year.

The utopian time of raising equity to any price named by companies has gone. In these difficult times for companies to raise capital, or even hold on to existing shareholders, the companies must comply with ethical processes to remain relevant. After all the pain, the Satyam episode may be a blessing in disguise and a wake up call for corporate India to come out clean and build on a more solid foundation.

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Finally, independent directors and audit committee members should face civil consequences for their gross misbehaviour.

Conclusion

Neharika Vohra

There are many issues that are important and need to be attended to. We need to understand the real meaning of corporate social responsibility — the same group that has perpetrated the fraud had also set up the Byrraju Foundation and Satyam Foundation. One of the main contributions of the foundation has been the setting up of EMRI and the emergency services call number, '108' in August 2005, which currently operates in eight states and aims to respond to 100 million emergency calls by 2010; further, in July 2008, they launched the '104' Mobile Health Service for providing healthcare to rural Andhra Pradesh.[10] Then, there are the issues revolving around measuring the performance of organizations holistically rather than single-mindedly maximizing wealth of shareholders quarter after quarter; pressures created by the obsessive need to grow at about 40 per cent every year; role of independent directors; and the basic questions about human nature and its compliance with the unethical demands of charismatic leaders. Hopefully, future researchers and practitioners will be able to engage in this debate and draw important insights for management of large entrepreneurial organizations.

1 Papri Sri Raman (June 23, 2008) Emergency? Indians can dial 108 for help Online document available at http://www.topix.net/forum/com/say/TM7TKK91JVINTSGAU