

Satyam Scandal Corporate Governance Case Study

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A Brief Introduction To The “Government Failure At Satyam”

- India’s ancient language is where the word Satyam is derived. It can also be referred to as “truth.”
- Satyam as a corporation won several financial awards due to its “smart and excellent” governance and practices before the fraud scandal hit the corporation’s reputation. Notably, after the scandal, the then Chief Executive Officer (CEO), Ramalinga Raju, through his resignation letter to the board of directors in January 2009, accepted the responsibility of the scandal that had summed up to 50 billion Indian rupees (INR).
- The aftermath of the Satyam scandal saw several board members resign as well, 115 members to be exact.

The History Of Satyam

- Before the fraud scandal, Satyam was one of the renowned corporations not only in India but on a global scale. The firm is an IT consulting firm as well as a leader in software development; it was ranked 4th among India’s most prominent software firms.
- Satyam company went public in 1991. After the issuance of the first shares of the company in 1992, Satyam significantly contributed towards the growth of India’s economy as well as its IT industry.
- After going public, 100% of the earned cash was used for the export unit through a technology park building.
- For sustainability purposes, Satyam prioritized forming business partnerships worldwide as well as in the local market. For instance, it has developed four of its subsidiaries in the local market: Satyam Enterprise Solutions, Satyam Infoway Pvt., Satyam Spark Solutions, and Satyam Renaissance Consulting.
- Satyam company also prioritized educational matters regarding information sciences and technology. For instance, in the local industry, it opened the Indian Institute of Information Technology (IT), whereas on the international platform, it developed a development center for software technology in the state of New Jersey in 1998 United States. Consequently, it saw several other global centers open.
- Through its better corporation partnerships with international partners, Satyam managed to

merge smaller companies and then build more alliances with other competitor corporations like Microsoft, Yahoo!, etc.

- Even if it's still unimaginable to approximate the revenue generated by the company, due to the realization of the inflated figures of the company's budget as reflected in the scandal, it's estimated that in the year 2008, Satyam generated revenues exceeding \$ 2 billion because of its vast number of associates from all over the world. By this time, the company had over 50,000 associates in over 60 corporate nations in Europe, Asia, America, etc. It also had over 600 customers, mostly from US companies, with over 30 solution centers located in its different corporate countries.
- Through the governance practices exercised by the Satyam company, it continued to receive several awards for its outstanding performances in the software industry, globally.

Governance

- Even if Satyam was an Indian firm, 40-50% of its ownership was from foreign institutions for investment. Also, some local banks and other institutions of finance had some property in the company. This shared ownership of the company amongst the invested required a corporative board that was tough and strong to keep the company's dominance not only in the local market but also globally.
- For instance, Satyam's board of directors (BOD) comprised five board members who were independent, as well as four other internal members of the committee. The board setting consists of the following;
 - The board chairperson, Raju and his brother (the two brothers are the founders of the firm)
 - One business professor from the business school of Harvard.
 - One internal Satyam worker
 - Four team members from the auditing and compensation committees.
- All the board settings were compliant with the stipulated corporation rules of India.
- In general, the governance report from Satyam Corporation required that "strong corporate governance can provide an important framework that can be standardized to promote long-term evaluability of the company."

Satyam's Financial Health

- The firm had consistently maximized profits each fiscal year.
- All the balance sheets, before the realization of the scandal, portrayed good signs of the firm.
- In the global and local platforms, Satyam had outstanding performances.
- Satyam's growth rate was proportional to profit generation
- Financial earnings steadily grew before the exposure of the scandal
- Notably, the top 100 of Satyam's customers increased their revenue by 85%
- As per the "international financial reporting standards" (IFRS), Satyam was India's first company

to post its audited results as per the IFRS regulations. As well as adopting the IFRS for the financial year of 2007 & 2008.

The Scandal's Unfolding

- For its expansion and diversity, Satyam had launched initial attempts of acquiring around 51% of the ownership of Maytas Infra, which could have summed up to approximately \$ 1.3 billion as well as 100% of its properties (\$ 300 million).
- For it to achieve the plan, it had to borrow \$ 300 million from the real estate firms/companies because it claimed that its cash accounts could easily cater for the other amount of \$ 1.2 billion.
- The board also had the feeling that, if it sourced for this alternative, it could see the Raju family and close allies hold substantial acquisition of stakes.
- However, the deal never went through as anticipated because some board members and investors objected to the idea, an effect that was reflected in the company's price fall of shares by about 30%.
- Consequently, after the drastic downfall of the shares, the entire Satyam firm was put in question as several quarters of investors and media press started to doubt Satyam's practices of governance.
- With the fear of Satyam's takeover from other firms, the company started to seek "share buy-backs." This is the time when the World bank realized some mischief conduct, of allegedly bribing its staff to benefit from lucrative deals and contracts, it eventually banned Satyam from doing any business with it for eight years on these grounds of bribery. However, the Satyam firm vehemently denied all the allegations from the World Bank.
- The major drawing point from the World Bank's ban on Satyam was the exponential decline of Satyam's prices of shares.
- Realizing the situation was getting out of hand, it saw board members resign one after the other. The first to render his resignation was the CEO of the company, Mr. Raju. He sent his resignation letter on 7th January 2009 to India's market regulatory body, i.e., the Stock and Exchange Board of India (SEBI), announcing the company's previous falsification of the financial figures and statements, which summed up to a total of INR71Billion, of which over 70% was "non-existing cash" due to overrated/inflated statistics of profits. However, in his resignation letter, Raju admitted that he never benefited from the inflated figures of the statement because he didn't sell his shares.
- This gross conduct from the two brothers, as a team, saw them arrested and imprisoned.
- Satyam crisis didn't stop there, the company's shares continued to drastically decline to about INR 40 from the initial price of INR 544.
- The drastic downfall of the shares forced Merrill Lynch company to terminate its engagement contract with Satyam.
- In the aftermath of the realization of the financial scam, several international firms sued Satyam on the same grounds of fraudulent business engagement.

Investigations On “Governance Failure At Satyam”

- As per India’s market regulatory standards, the Central Bureau of Investigations (CBI) was mandated the responsibility to conduct an external and internal forensic audit on all the firm’s previous financial statements and figures. After the study, the CBI conclusively reported to the authorities that Satyam’s inflated profits were exceeding INR 96 billion.
- Even if Raju had claimed that the company only made 3% net profit during that period, the claim was not substantial according to the CBI’s findings.
- It was meant just for possibly personal/private gain. For instance, from the investigation, it was discovered that both Raju and his close allies (friends and families) had several private companies that were, registered under their names.
- However, Raju defended this finding and said that because the companies registered under the family’s names were private and thus didn’t require any practices of standardized governance.
- From the CBI report, it was, pointed out as well that the company’s external auditors (PricewaterhouseCoopers (PwC)) were involved in this business fraud of Satyam.
- For instance, the CBI report that to keep Satyam’s irregularities unexposed to the public, Satyam could pay PwC to double the amounts of what other IT firms could pay for their auditing.
- CBI’s report also suggested that some banks could have been in coordination with Satyam to keep the fraud down low from getting to the public. The investigations found that these banks authorized fake bank statements as well as financial figures, something that Raju confirmed in his letter of resignation to the SEBI.
- Due to external and internal pressures for their fraud involvement, the head of PwC’s auditing team resigned from office.
- Tellingly, the two partners that had signed the authorization of Satyam’s inflated figures were suspended from their work and eventually imprisoned.

The Aftermath Of Satyam’s Crisis Of Governance

- To save the company from going bankrupt, the government appointed an interim board to Satyam.
- However, the board faced numerous challenges in trying to solve the situation in the company.
- Afterward, Tech Mahindra, together with the Mahindra group Co., successfully bid for Satyam company.
- The Mahindra Group Co. paid INR 17.57 billion for Satyam’s 31% stake and decided to run it as a private company with separate liabilities.

What were the circumstances under which

Satyam's fraud was exposed? What do you think were the reasons for the deception? Could this fraud have been prevented? Evaluate the statements made by the chairman in his resignation.

- Due to the failed attempt at acquiring Matyas companies of real estate, it became relatively easy to expose Satyam's fraudulent activities.
- It's presumed that the intention of the attempt to acquire these real estate companies was to supplement the cash that could balance the inflated figures of money at the banks.
- Raju, by all means, didn't want to accept an impending takeover, and hence, they tried to manipulate their levels up the scale, but this one scandal blew up the whole fraudulence within Satyam.
- I strongly feel that when the financial crisis started to hit Satyam and the board feared the possible takeovers, Satyam began to the fraud such that it could maintain its client base as well as keep its investors could enable them to raise the prices per share in the stock market.
- Notably, initially, the company was doing well internally when it went public. However, when the fraud started getting worse, Raju failed to clean the mess due to inadequate resources. This can be articulated critically from his point that "the fraud was like riding a tiger without knowing how to get off it without being eaten."
- The Satyam firm could have reduced or avoided this fraudulence in several ways like;
- Through constant rotation of the auditing partners within the PwC.
- Through creating several duties of separation like alternating persons who are doing multiple works such that they could foster internal control of the company's board.
- Through enacting regulations that are though.
- As well Satyam could have conducted thorough investigations into their "sketchy bank statements."
- During Raju's resignation as the chairperson of Satyam, he made the following statements;
- He acknowledged that the fraud took a twisted turn when he lied about the company's margins of profit(s). He took responsibility for deliberately inflating figures as well as underestimating the company's liabilities, something that caused Satyam's governance failure.
- Raju stated that, in the process of the company's growth, its "artificial amounts" as well kept growing to the extent of being unmanageable (portraying Satyam's governance failure)
- Regardless of the fraud's close link to his family, Raju vehemently stated that neither he nor any of his family members benefited from the inflated financial figures.
- Raju also noted that nobody else had the tip-off about this misstatement within the company.

Critically evaluate the corporate governance mechanisms adopted by Satyam. Define and Fully discuss The [4] corporate governance mechanisms [From Our Text] about the Satyam cases. Were the corporate governance mechanisms at Satyam Adequate? Why or why not? Specifically, discuss Each governance mechanism in detail, addressing the Adequacy of each relative to Satyam.

- The concentration of ownership:
- Because Satyam had huge shareholders and stakeholders, it then meant that these shareholders were the ones who enacted more decision-making policies for the company.
- Lack of monitoring and making decisions implemented in the company, Satyam became ineffective in monitoring the board's actions as well as decisions. This can be extrapolated through the ineffectiveness that led to the fraud due to inadequate mechanisms of enacting policies because a large number of the block shares and other stock percentages were owned by external/foreign investors (Leslie and Ireland).
- Board of Directors (BOD).
- Like any other corporation or organization, the BOD is meant to have the best interest of the company at heart.
- With this regard, the scandal extrapolated the inadequacy of Satyam's BOD; this is well stated and articulated as the chairperson, Mr. Raju, failed to perform his duties diligently because he facilitated the fraud through his deliberate inflations of the financial figures (Leslie and Ireland). The
- Executive Compensation.
- The executive compensation corporative governance is meant to "seek alienation of the interests of the managers and other owners/shareholders through either bonuses, salaries or long-term incentives."

With this regard, Satyam's employees' bribery and overcompensated audits due to inadequate mechanisms of governance led to the violation of this code of governance which eventually led to the evolvment of the scandal (Leslie and Ireland).

- The market for control of the corporate.
- Any market for corporative control is always active if the mechanisms of the corporation's internal governance fail.

Regarding this governance, the aftermath of the unfolding of this scandal saw Satyam's whole BOD replaced, plus other top executive members and managers of the firm, such that adequate governance mechanisms can be restored in Satyam's firm (Leslie and Ireland).

Examine the role of internal controls in the prevention of fraud. What characteristics of the board of directors play a role in preventing financial statement fraud?

- By definition, internal control is "any process that is put in place such that it can prevent, detect and correct financial misstatements, if any." In simple words, the internal control detects and corrects fraud.
- It helps mostly in responsibility maintenance like safeguarding the firm's assets, complying with the standards of regulations as well as financial laws, and most importantly, reporting financial reliabilities.
- Any internal control team that is viable and feasible in the market is committed to ensuring integrity, improving the firm's corporative governance (by providing that all employees are competent in their duties), and transparency of the firm's cash and liquid assets, which increases accountability of the firm's financial status.
- The responsibility of the BOD is to implement procedures as well as policies that can reduce the chances of financial misstatements.
- They should prioritize general reviews of performance through independent legal procedures and checks.
- For them to realize this objective, there is a need for the BOD to use control's info processing to ensure minimal misstatements of their financial statements (Nisha and Gaur).
- They should as well, over time, assess their controls routinely such that they can minimize the cases of risking fraud during the firm's necessitated changes of growth.

Assess the responsibility of audit committees as well as internal auditors about the Satyam scandal. Do you think making regulatory changes would help in preventing such fraud?

- The responsibility of the auditing committee is to hire auditors who are then charged with the responsibility of reliably sourcing for accurate financial statements and the status of the firm's governance (Quinn and Mullis 567).

- Internal auditing can be as well be defined by the internal auditors as “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations by helping it accomplish its objectives through a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, internal control, and governance processes.” within a firm. (Quinn and Mullis 567).
- Regarding Satyam’s scandal, both the committee and auditing team failed to diligently execute their duties because their internal controls weren’t efficiently monitored, a factor that led to the fraud. As well as, the team was unable to either detect the scam or prevent it from spreading.
- I think that some regulatory changes and enactments could have identified and solved the fraud before getting it out of hand. For instance, the regulatory changes that could have needed are, but not limited to;
- Auditing staff could have been assigned to areas that are deemed to have high risks to gather the necessary experience for the job.
- Implementation of more extensive and intensive supervision of financial resources.
- Incorporating diversified elements and proponents in their audits, etc.

Legal And Ethical Implications- Develop two persuasive arguments regarding the legal and ethical implications of this case (at least one legal and at least one moral, with support for each). Please use separate subheadings and designate which are the legal vs. ethical issues, as well as your arguments and supporting evidence for each.

- On matters of legal implication(s).
- From Mr. Raju’s resignation letter and the CBI’s finding report, Satyam inflated financial figures to “entice” the stakeholders and customers and continuously engaged in bribery with the PwC as well as some of the World Bank’s members of staff to procure lucrative business deals. All these breached/violated the market authorities’ tax regulatory rules.
- After, Satyam’s chairperson’s resignation, investigative body (CBI), reaffirmed the reports that the firm’s increased amounts were exceeding INR 96Billion.
- The report also reaffirmed the fact that due to this vastly inflated figure, undoubtedly PwC’s auditors deliberately or “manipulatively” looked past this gross financial mismatch, perhaps because they could get double the auditing fee from the firm as compared to what their other IT auditors could get from other firm’s audits.
- Regarding this financial conspiracy, Mr. Raju, the Satyam chairperson, was charged.
- CBI’s investigatory report revealed that Raju and his close family members and friends had

opened over 327 private entities of companies under their name(s).

- To an extent, it's alleged that these private companies did play a massive role in concealing Satyam's misappropriated financial figures that were reported to either the public domain or directly to the investors.
- Satyam's scandal analysis on ethical implication(s).
- The scandal quickly tarnished Satyam's "prestigious" or essential form of governance.
- The board failed to take responsibility for their duties because of the deliberate inflation of the company's financial information and liabilities, thus violating the ethical policies governing the firm.
- The company's misappropriation of its profit margins was misleading to both the stock exchange as well as to Satyam's investors.
- Most importantly, any public firm pledges maxima return on investment (ROI), and thus Satyam's false reporting on its liabilities, assets as well as cash is a violation of this regulation.

Critical Thinking Question- Craft a meaningful/critical thinking question for this case and provide what you consider to be an Excellent answer.

- How did Satyam's BODs and Chairperson collude to falsely inflate the financial status and profit margins of the firm?
- They underestimated and hid the liabilities as well as overstating assets, a fact that can be drawn from the fact that in the year 2008 the firm ended the financial year with approximated INR 1.2billion debt, despite the fact of "huge" fiscal balances in the banks.
- Showed "fictitious" bank deposits in their reports, which could potentially incur the company's inflated rates of interest.

Epilogue: Update the case from the time that the trial ended. Please include Strategic milestones (separate heading/ list several) and Financial milestones- i.e., performance measures (different heading/ list several). What are the lessons

learned from this case?

- The aftermath of the fraud saw the company's market capitalization drop more than 70% (Nisha and Gaur).
- In February 2008, during the "rebuilding process," SEBI, through a public bid advert, allowed the sale of almost 51% of Satyam's shares.
- Mahindra Corporation won the bid for Satyam (INR 58 per share).
- Tech Mahindra had paid for a stake of 31%.
- Afterward, the Tech company decided to run the company as a separate liability and as a private company.
- The main lesson that can be drawn from this fraud is that, for any significant and international companies to succeed, their corporate governance mechanisms should be healthy to carry out their mandate and duties effectively.

Work Cited

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