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Corporate Governance in India: Case Study of Satyam

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ABSTRACT

In the present study, status of corporate governance in pre and post liberalization period in India has been talked about. After that, Satyam fiasco has been discussed. The lessons learnt from Satyam saga will help in improving the corporate governance in India in the years to come.
Role of independent directors will be under close scrutiny and the auditing firms will be very careful while auditing the accounts of companies in future. From the Satyam episode, it is concluded that more training of audit committee members is required. The challenge is to design and sustain a system that imbibes the spirit of corporate governance and not merely the letter of the law.

Keywords : corporate governance

Introduction

Corporate governance is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. The principal stakeholders are the shareholders, the board of directors, employees, customers, creditors, suppliers, and the community at large. Good corporate governance practices are a sine qua non for sustainable business that aims at generating long term value to all its shareholders and other stakeholders. It promotes the development of strong financial systems – irrespective of whether they are largely bank-based or market-based – which, in turn, have an unmistakably positive effect on economic growth and poverty reduction. It enhances access to external financing by firms, leading to greater investment, as well as higher growth and employment. It also lowers the cost of capital by reducing risk and creates higher firm value. Effective corporate governance mechanisms ensure better resource allocation and management raising the return to capital. The return on assets (ROA) is about twice as high in the countries with the highest level of equity rights protection as in countries with the lowest protection.

Corporate governance is a topic of hot debate in developed countries like U.K. & U.S.A. for the last two decades. However, there has been renewed interest in the corporate governance practices of modern corporations since 2001, particularly due to the high-profile collapses of a number of large U.S. firms such as Enron Corporation and MCI Inc. (formerly WorldCom). Enron, Texas based energy giant, and WorldCom, the telecom behemoth, shocked the business world with both the scale and age of their unethical and illegal operations.

With the opening up of economies, it has also been a concern for developing country like India. This is because opening up of economies has changed the scenario of Indian market i.e. on one hand, it has made the world market accessible to the Indian corporates & on the other hand, it has increased competition in the domestic market with the advent of the multinational companies. In this changed scenario, the quality of governance has been an important factor not only for survival of the companies but also for influencing the company's ability to raise money from capital market. Again corporate governance is important in Indian context because of the scams that occurred since liberalisation from 1991, for e.g. the UTI scam, Ketan Parekh scam , Harshad Mehta scam, Satyam Fraud case.

In this paper, an attempt has been made to know the status of corporate governance in India in pre and post liberalization period. After that, Satyam fiasco has been discussed. Then, it will be discussed that how the lessons learnt from Satyam saga will help improve the level of corporate governance in India in the years to come.

Corporate governance in India in pre- liberalization period

Corporate development in India was marked by the managing agency system, which contributed to the birth of dispersed equity ownership & also gave rise to the practice of management enjoying controlling rights disproportionately greater than their stock ownership. The enactment of 1951 Industries (Development & Regulation) Act & the 1956 Industrial Policy Resolution marked the beginning of a regime & culture of protection, licensing & red tape that encouraged corruption & stilted the growth of the Indian corporate sector. Soon, corruption, nepotism & inefficiency became the hallmark of Indian corporate sector. The corporate bankruptcy & reorganisation system was also not free from problems. In 1985, the Sick Industrial Companies Act (SICA) and in 1987 the Board for Industrial & Financial Reconstruction (BIFR) were set up. According to SICA, a company is declared 'sick' only when its entire net worth has been eroded & it has been referred to BIFR. The BIFR usually took over 2 years on average just to reach a decision with respect to the companies. Only a few companies emerged successfully from the BIFR & the legal process on average took more than 10 years by which the assets of the company were virtually worthless. Thus, protection of the creditors' rights existed only in paper & the bankruptcy process was featured among the worst in the World Bank survey on business climate.

Although the Companies Act 1956 provided clear instruction for maintaining & updating share registers, but in reality minority shareholders often suffered from irregularities in share transfers & registrations. There were cases where the rights of the minority shareholders were compromised by the man-

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agement's private deals in case of corporate takeovers. Thus, in the pre-liberalization era the Indian equity markets were not sophisticated enough to exert effective control over the companies. Listing requirements of exchanges provided some transparency but non-compliance was not rare & was also not punished.

Corporate governance in India in post- liberalization period

Liberalization of the Indian economy began in 1991. Since then, there have been major changes in both laws & regulations & in the corporate governance landscape. The most important development in the field of corporate governance & investor protection has been the establishment of the Securities & Exchange Board of India (SEBI) in 1992. It has played a crucial role in establishing the basic minimum ground rules of corporate conduct in India. The next significant event was the Confederation of Indian Industry (CII) Code for Desirable Corporate Governance developed by a committee chaired by Rahul Bajaj. The committee was formed in1996 and it submitted its recommendation on April 1998. Later two more committees were constituted by SEBI, one chaired by Kumar Mangalam Birla & the other by Narayana Murthy. The Birla committee submitted its report in early 2000 and the second committee submitted its report in 2003. The recommendation of these two committees had been instrumental in bringing major changes in the corporate governance through the formulation of Clause 49 of the Listing Agreement. Along with SEBI, the Department of Company Affairs and the Ministry of Finance, Government of India, also took some initiatives for improving corporate governance in India. For example, the establishment of a study group to operationalize the Birla Committee recommendations in 2000, the Naresh Chandra Committee on Corporate Audit and Governance in 2002 and the Expert Committee on Corporate Law (J.J. Irani Committee) in late 2004. SEBI implemented the recommendations of the Birla Committee through the enactment of Clause 49 of the Listing agreement. It came into effect from 31 December 2005 It is similar to Sarbanes - Oxley Act (SOX) in U.S. Clause 49 looks into the following matters; (i) composition of the board of the directors, (ii) composition and functioning of the audit committee, (iii) governance and disclosures regarding subsidiary companies, (iv) disclosures by the company, (v) CEO/CFO certification of the financial results, (vi) reporting on corporate governance as part of the annual report, (vii) certification of compliance of a company with the provisions of Clause 49.

Clause 49 can be referred to as a milestone with respect to the changes in corporate governance in India. With its introduction, compliance with its requirements is mandatory for listed companies. It has been formulated for the improvement of corporate governance in all listed companies. But, the whole corporate governance issue is popping its head up again after the Satyam episode.

Satyam fiasco

Satyam scam had been the greatest scam in the history of corporate world of the India. Satyam Computer Services Ltd, the fourth largest IT company in India, was founded in 1987 by B. Ramalinga Raju. The company was offering information technology (IT) services spanning various sectors, and was listed on the New York Stock Exchange and Euronext. Satyam's network covered 67 countries across six continents. The company employed 40,000 IT professionals across development centers in India, the United States, the United Kingdom, the United Arab Emirates, Canada, Hungary, Singapore, Malaysia, China, Japan, Egypt and Australia. It was serving over 654 global companies, 185 of which were Fortune 500 corporations. Satyam had strategic technology and marketing alliances with over 50 companies. Apart from Hyderabad, it had development centers in India at Bangalore, Chennai, Pune, Mumbai, Nagpur, Delhi, Kolkata, Bhubaneswar, and Visakhapatnam. In September 2008 the World Council for Corporate Governance honored the Satyam with a "Golden Peacock Award" for global excellence in corporate governance.

On January 7, 2009, Satyam scandal was publicly announced & Mr. Ramalingam confessed and notified SEBI of having falsified the account. Raju confessed that Satyam's balance sheet as on 30 September 2008 contained:

1. Inflated (non-existent) cash and bank balances of Rs 5,040 crore (as against Rs 5,361 crore reflected in the books) on the balance sheet as on September 30, 2008
2. An accrued interest of Rs 376 crore which is non-existent
3. An understated liability of Rs 1,230 crore on account of funds
4. An overstated debtors position of Rs 490 crore (as against Rs 2,651 reflected in the books)
5. For the September quarter, Satyam fraudently reported a revenue of Rs 2,700 crore and an operating margin of Rs 649 crore (24% of revenues) as against the actual revenues of Rs 2,112 crore and an actual operating margin of Rs 61 crore (3% of revenues). This has resulted in artificial cash and bank balances going up by Rs 588 crore in Q2 alone.

Raju acknowledged that the gap in the balance sheet had arisen on account of inflated profits over a period of last several years.

The scandal came to light with a successful effort on the part of investor's to prevent an attempt by the minority shareholding promoters to use the firm's cash reserves to buy two companies owned by them i.e. Maytas Properties and Maytas Infra. Raju wanted to buy the entire stake in Matyas Properties for $ 1.3 billion and 51% stake in Maytas Infra for $ 300 million to cover the scam he was cooking. As a result, this aborted an attempt of expansion on Satyam's part, which in turn led to a collapse in price of company's stock following with a shocking confession by Raju, The truth was its' promoters had decided to inflate the revenue and profit figures of Satyam thereby manipulating their balance sheet consisting non-existent assets, cash reserves and liabilities.

Lessons from Satyam episode

Satyam fiasco has put spotlight on some of the corporate governance practices and has exposed the weaknesses: Lax Regulatory systems; the imperious and machiavellians promoters/ CEOs and their unbridled greed; connivance and collusion of Auditors and poor auditing practices and timid and acquiescent independent directors.

The silver lining to this whole episode was the ascendancy of the Shareholders Activism. The institutional shareholders and investment analyst vehemently reacted to information of buying Matyas by Satyam Computers. Ramalinga Raju was left with no option but to abandon the plan of buying Matyas. He also had to put in his papers, confessing cooking of the books for several years.

The good thing about the multi- crores scandal is that the lessons learnt from Satyam saga will help improve the level of corporate governance in India in the years to come. Role of Satyam's independent directors is termed as 'unpardonable', it means acting against the interest of large shareholders especially when the promoters themselves owned a little more than 8 per cent stake in the company and institutional investors owned more than 45 per cent. Independent directors of Satyam computers, who agreed to the company's proposal of buying out two promoter- related companies, failed to be independent in spirit. Role of independent directors will be under close scrutiny now. They need to be more active and need to maintain their independent spirit. They need to be vigilant in protecting minority interest and be brave enough to take adequate steps.

Fingers are also pointed out at the possibility of the auditors Price Waterhouse Coopers (PWC) being hand in glove with the conspirators in the multi- crores scam. It is highly unlikely that auditors did not have any idea about the scam brewing for so many years. Credibility of audit firms has come into question as the amount was too big for any audit firm not to notice. Therefore, now the auditing firms will be very careful while auditing the accounts of companies.

Conclusion

In the present study, status of corporate governance in pre and post liberalization period in India has been talked about. After that, Satyam fiasco has been discussed. The lessons learnt from Satyam saga will help in improving the corporate governance in India in the years to come. Role of independent directors will be under close scrutiny and the auditing firms will be very careful while auditing the accounts of companies in future. From the Satyam episode, it is concluded that more training of audit committee members is required. The challenge is to design and sustain a system that imbibes the spirit of corporate governance and not merely the letter of the law.

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