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SATYAM SCANDAL AND CORPORATE GOVERNANCE FAILURE CASE STUDY

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ABSTRACT

The Satyam Computer Services Ltd. scandal in India serves as a stark reminder of the critical importance of effective corporate governance. This case study delves into the heart of the matter, highlighting key facts surrounding the scandal, identifying the central issues that led to its catastrophic failure, and proposing alternative courses of action to prevent such incidents in the future.

Founded in 1987, Satyam initially appeared as a promising player in India's IT sector, growing rapidly and even being listed on NASDAQ in 1999. The company's downfall, however, began in 2008 when its CEO, Ramalinga Raju, shockingly confessed to inflating the company's financial data. This revelation triggered a cascading series of events, including being blacklisted by the World Bank and a 78% drop in share prices.

The key issues at the heart of Satyam's collapse were the failure of independent directors, audit committee shortcomings, issues with transparency and disclosure, and the failure of the CEO/CFO to fulfill their roles effectively. Independent directors neglected their duty to investigate the company's questionable financial practices, while the audit committee failed to ensure accurate financial reporting. Additionally, the lack of transparency and disclosure misled stakeholders, resulting in significant financial losses.

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Three alternative courses of action were proposed: separating responsibilities, engaging independent supervision, and government intervention. While each had its merits, government intervention emerged as the recommended course of action due to its potential to provide the necessary oversight and control over large enterprises. This approach, although resource-intensive, would address the fundamental flaws that contributed to Satyam's downfall.

In conclusion, the Satyam scandal underscores the need for robust corporate governance practices. It serves as a cautionary tale for companies worldwide, emphasizing the critical role of transparency, accountability, and ethical leadership in preserving trust and preventing corporate disasters. By implementing measures such as government intervention and upholding corporate governance principles, companies can mitigate the risks associated with unethical behavior and financial misconduct.

INTRODUCTION

Corporate governance has been implemented in India for about two decades. Nonetheless, several examples of disastrous corporate behaviour demonstrate that the country's corporate governance framework must be more effectively and appropriately created. Satyam Computer Services Ltd ("Satyam"), India's 4th-largest computer services firm, was the most recent occurrence.

Satyam was a big failure due to critical faults in the governance system; because of its management personnel, stakeholders, and partners, it has caused several losses and challenges. The current examination of the Satyam case study aims to find the most essential facts, investigate the critical issues involved, propose several courses of action, assess them, and recommend the most suitable activity.[2]

The Most Important Facts Surrounding the Case

The essential facts associated with the case are as follows:

[2]**Reference**
IvyPanda. (2020, November 13). *Satyam Scandal and Corporate Governance Failure.* https://ivypanda.com/essays/satyam-scandal-and-corporate-governance-failure/

1. On 27 June 1987, Ramalinga Raju founded Satyam Computer Services along with his brother-in-law. At first, there were as few as twenty employees. Still, the organisation determined itself as a large-scale player in the country's IT sector, concentrating on the services concerned with software outsourcing.
2. 1991, the company made a successful first public appearance on the Bombay Stock Exchange. The company launched Satyam Infoway ("Sify") four years ago and suggested back-office outsourcing to US and European customers. In 1999, Sify operated in thirty countries and became the first company from India to be listed in NASDAQ (National Association of Securities Dealers Automated Quotations).
3. Raju was on good terms with Indian business and political leaders. In 2000, during the US President's visit to Hyderabad, Raju shared the podium with him. He built friendly relationships with many other leaders and influential people.
4. In 2007 Satyam was appointed the official IT service provider for the FIFA World Cup in 2010 in South Africa and the FIFA World Cup 2014 in Brazil. The same year, Raju was awarded the Ernst and Young Entrepreneur of the Year award for expanding his IT company to more than 50,000 employees. Raju was regarded to be one of the most successful Indian businessmen in many countries of the world.
5. In 2008, the company's revenues exceeded $2 billion, and Satyam won many distinguished awards. Raju co-chaired the November World Economic Forum Summit in New Delhi, India. At the summit, Raju announced his firm's outstanding performance and promised to find a way out for Satyam in the global economic crisis.
6. The company's downfall started at the end of 2008, after Raju's shocking confession about inflating the data concerning the company's performance. On 23 December, Satyam wasblocked for eight years by the World Bank based on bribing bank officials and data theft. The beginning of 2009 was marked by the company's fall, preceded by Raju's shocking confession about numerous manipulations and fraudsters in Satyam. After the confession letter, the company's drop in share price was 78%.

7. Satyam's actual cash and bank balance were $65 million, while the inflated balance was $1.03 billion. The excessive accrued interest was $7.7, whereas there was none. The actual liability was undisclosed, while the exaggeratedpenalty was $252 million. Moreover, the exact number of employees was 10,000 more minor than the number reported by Raju – there were 40,000 employees instead of the 50,000 mentioned. Raju used made-up names to redirect $4 million monthly from the company's accounts.

The Key Issues

Satyam's disastrous collapse was driven by four major factors: a lack of independent members on the company's board committee, problems in audit, challenges with disclosure and openness, and a failure in the CEO/CFO function.

Failure of Independent Directors

Satyam's demise was inextricably intertwined with the function of independent directors. These individuals were supposed to manage the company's activities. On the other hand, they needed to show more interest or care about the state of affairs at Satyam. The corporation's independent directors should have investigated why it was keeping so much cash on hand, yet they have yet to do so. On the contrary, knowing that such behaviour may harm the company's stakeholders and partners, they kept silent for several years.

The acts of Satyam's independent directors are, at best, imprudent. This negligence bordered on deception because keeping silent regarding a significant crime is essentially the same as participating.

Drawbacks in Audit

The primary objective of an audit committee in the firm would be to ensure that all stakeholders know and understand the firm's actions. But, in the case of Satyam, its audit committee did not

[3] *https://tradebrains.in/satyam-scam/*

carry out its responsibilities. These actions led Satyam's control system to collapse and did not provide a fair picture of the company's financial status. The audit committee needed to do its job restricting false information concerning Satyam's economic problems.

The audit committee's failure to provide accurate facts to the board had a detrimental influence on the organisation's performance.

Problems with Disclosure and Transparency

One of the pillars of business success is the transparency disclosure of a company's materials, which allows the actual state of things to be observed and assessed. The corporation demonstrates its capacity or inability to do business by exhibiting these principles, and stakeholders can determine its prospects. In the case of Satyam, neither openness nor disclosure were offered. The information supplied by Raju needed to adequately reflect the existing situation, resulting in investors losing large sums of money without even realising it. All the information provided to stakeholders was fabricated, and nobody suspected anything was wrong with the company.

Therefore, Satyam's disclosure and transparency standards limited access to realistic data significantly.

Failure in the CEO/CFO Role

Satyam eventually became dissatisfied with his duties as CEO and CFO. Corporate governance principles presuppose that the CEO/CFO ensures the organisation's financial statements are factual and honest. Sadly, Satyam's CEO Raju CFO Vadlamani both failed to perform satisfactorily. Due to their illegal conduct, which suppressed legitimate financial data, the company's investors, stakeholders, and clients were unaware of Satyam's dire predicament.[4]

[4]*https://www.academia.edu/10971389/SATYAM_SCANDAL_A_case_study_*

The misconduct of the organisation's key personnel harmed the company's plans and achievements. Since nobody realised the data were inaccurate and couldn't plan any operations to address the situation; the entire strategy was built wrongly.

Alternative Courses of Action

Failures in Satyam's operations at all levels necessitate a complete review of the company's work and the identification of potential solutions. Satyam's three options appear plausible: separating responsibility, engaging independent supervision, and government intervention. By spreading duties, the corporation would have avoided concentrating power and knowledge availability in the hands of one or a few people.

Engaging impartial supervisors would have reduced the fraud schemes because independent curators focus on uncovering defects in the organisation's work rather than personal benefit. Government intervention would have shown the firm that it always has more authority than its management. If the government had given attention and control, Raju wouldn't have felt as strong and might not have been capable of carrying out many illegal actions in Satyam.

Evaluation of Each Course of Action

Dividing the Responsibilities

The first technique advised is to spread duties among business members rather than placing the majority of authority in the hands of only one or few people. Many workers will feel more responsible and devotedto this highly objective evaluation if they know they must collaborate and regularly examine the organisation's outcomes. Also, when someone planning illegal acts knows their actions would be seen and read by others, their plans to conduct fraudster may be reconsidered.

For instance, if Raju had known that anybody other than himself might detect errors in financial records, he wouldn't have had the motivation or, if not the least, the chance to bring such disastrous consequences. The costs associated with this action are inexpensive since the participants might be drawn from the management staff or other subordinates. However, the benefits are significant: every member of the organisation would be aware of the absence of a way to participate in illegal actions since many individuals will be held accountable for various phases of the procedure, and they will compare this data regularly.[5]

Inviting Independent Supervisors

This option is a little more time- and money-consuming. Yet, the benefits associated with this strategy would outweigh the costs. The complicated technique of concealing vast amounts of cash would have proven impossible if Satyam had invited independent auditors. Those on the outside would not have any personal preferences; their evaluations would have been far more objective. Additionally, bribing supervisors was only possible because the company's leader couldn't predict who would be assigned to review the financial data.

Government Intervention

The third proposed approach, while requiring more significant resources, does have the potential to safeguard the organisation from disaster. As the Satyam case demonstrates, the entire country had become a symbol of such a fraudster, losing the trust and support of several ex-partners worldwide. As a result, maintaining government control over such big enterprises is vital. If the government had interfered sooner, it would have been possible to discover Satyam's problems and devise solutions to salvage the situation.

The Best Course of Action Recommended: Government Intervention

Although government action is the most cost-consuming of the alternatives, it is the most productive. The other two options have specific merits but convey different amounts of control. Moreover, as the case of Satyam demonstrates, a lack of power was a fundamental contributor to the company's demise.

The feasibility of government intervention was lower than that of responsibility sharing. Yet, it is well within reach from such a technical and operational sense. Government engagement implies

[5] https://www.researchgate.net/publication/304441053_Revisiting_the_Satyam_Accounting_Scam_A_Case_Study

more control and almost exact costs than inviting independent monitors. As a result, considering all risks and rewards, this is the best course of action.

Satyam’s culture, dominated by the board, represented an immoral culture. Unlike Enron, which collapsed owing to an issue with the agency, Satyam was driven to its knees by the tunnelling effect. All types of scams have demonstrated the importance of excellent behaviour based on strong ethics. Keeping in mind the management’s method of operation in the Satyam fraud, some significant recommendations have been suggested hereunder:

1. Corporations must promote their CEOs’ moral, ethical, and social principles.
2. Board members must understand the gravity of the trust placed in them and be proactive and vigilant in safeguarding owners' interests.
3. In Satyam’s situation, there was a lack of accurate and timely information.
4. Shareholder activism is an effective way to keep a firm and its management in check.
5. Block-holders and institutional investors can also help hold the board and management accountable. Finally, the CG framework must be followed to the letter and the spirit.

Conclusion

Perhaps India's most successful computer software firms' sad tragedy provides vital lessons. Due to fundamental deficiencies in Satyam's corporate governance architecture, the CEO was able to engage in several illegal activities while going unnoticed for several years. Satyam's audit was flawed, as were concerns with openness and disclosure and failures of independent directors' CEO/CFO duties.

Given the enormity of the losses generated by such flaws, it is critical to reconsider how large firms build their governance structures. To avoid such disasters in the future, independent supervision shared responsibilities, and government control are essential. While such efforts may need more resources, the result will benefit the company, its employees, and the country whose reputation such enterprises must preserve.[6]

[6]http://nja.gov.in/P-948_Reading_Material/P-948_Audit_of_Fraud_in_economic_crimes/ACCOUNTING%20FRAUD.pdf