Is blood thicker Than Water? Appraising Adequacy of Indian Corporate Governance Framework For Family Based Companies: A Case Study On Satyam Computers

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30 April 2010

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Abstract:

One third of the Indian companies are controlled by one or another family members in concert. In recent past corporate governance crisis is surfaced in few family controlled business houses. We studied financial & market performance of 44 top Indian companies listed in Forbes Global 2000, which includes 19 family controlled companies. We compared financial & market performance of family based companies with the non-family based companies. It is observed that family based business have higher revenue and profit generating capabilities, but we observed greater fall in market value of their securities during 2008.

Our research identified companies, which faced corporate governance problem. It is found that one third of the family based companies have corporate governance problems. Our investigation shows that in spite of strong corporate governance framework & series of legislation in India, top management violates governance norms either to favor family members or due to jealousy amongst sibling. It is found that there is lack of supervision and inefficiency in prosecuting violators. We investigated in detail the recent serious governance failure at India's 4th largest IT firm, Satyam Computers Services Limited and reasons of such large magnitude failure of checks & balances in action. We have used primary & secondary data to substantiate the conclusion using appropriate research techniques. The research is useful to the policy makers in designing & implementing corporate governance framework in general & special to family based companies.

Introduction:

Before the word 'corporate governance' became a buzzword in the modern era, Indian culture & literature widely referred & advocated good corporate governance in spirit without naming it as corporate governance. The Directive Principles mandates that the State should work to prevent concentration of wealth and means of production in a few hands, and try to ensure that ownership and control of the material resources is distributed to best serve the common good. [Article 38, Constitutional Law of India] Gandhian philosophy is based on 1st verse of Ishopshinad (sacred Hindu literature), which vows, "Tena Tyaktena bhunjithah…", where, one is asked to dedicate everything to God and then use material things only to the required extent. The message enshrines that one must not covet what belongs to others. A corporate entity stands on the pillars of Trusteeship and Accountability. According to a study (1998) conducted on ownership, 30% businesses are family controlled, 36% are widely held while 18% are state owned. In India, major business houses are equally controlled by family or otherwise. 17 of 30 companies in SENSEX (how security index at Bombay Stock Exchange known as) are family controlled. In our study comprised of 44 top Indian companies listed in Forbes Global 2000, 19 companies are family controlled.

Till 1980, majority of big corporate houses in India were family run businesses and founded by first generation entrepreneurs. The then biggest & successful business houses like Tata, Birla & Bajaj practiced voluntarily all good corporate governance practices by spirit. A century old Memorandum of Tata referred Corporate Social Responsibility and in spite of absence of any express code for corporate governance, there was no major failure on governance issues in these business houses. Indian Company Act, 1956 contains express legal code, which are pertaining to good corporate governance practices.

Indian corporate has taken challenges of globalization and has grown at 7-8% per annum. 25% of GDP is from manufacturing sector while 55% from service sector. Over 700,000 companies are registered in India till 2007, which was little over 1,00,000 in 1991, the year when India embarked to economic reforms. Primary & secondary market also has grown manifold in the last two decades. Due to series of economic & legal reforms, the business has grown so as problems of governance. As per report by Ministry of Company Affair's statement in 2006, over 400 companies listed on the stock exchanges in Mumbai are facing prosecution for violating various statutory requirements. The Department of Company Affairs (DCA) has moved for prosecution of these companies as they failed to file annual returns and submit balance sheets, mandatory under the Companies Act provisions.

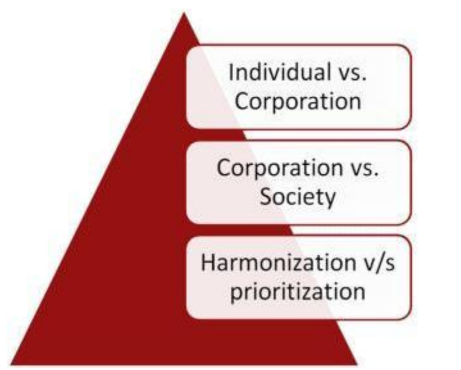
Principle of trusteeship:

After 1995, with global movement on corporate governance, India too formulated committees on corporate governance (namely – Kumar Manglam Birla, Narayan Murthy, Naresh Chandra & J.J. Irani Committee) at various level and basis of recommendation of such committees, SEBI (Security Exchange Board of India) codified clause 49 as part of security listing agreement. These codes are applicable to listed companies only, and there is no similar code for un-listed company how so big it is. Government of India announced guidelines in 2007 on corporate governance for Central Public Sector Units. However it is voluntary in nature. Various Accounting Standards also incorporated financial issues on conflict of interest, related party transactions, transparency & disclosure. Clause 49 is exhaustive and provide for composition of board & audit committees of independent directors, risk management, many specific disclosures in Annual Reports and certifying financial results.

As Institute of Company Secretaries of India states, "For making corporate governance work, we have to go through a profound metamorphosis and develop an inner value system which prides on ethics, morality, equity, legitimacy, transparency and values dissent and diversity." SEBI committee defined corporate governance: "Corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company." Indian cultural values are imbibed in corporate governance norms. We studied top Indian companies in terms of financial & market performance & probed companies facing governance problem and reasons thereof.

Issues in Family Controlled Business:

Due to high involvement of the promoters in business activities, either at strategic level or in day-to-day affairs, business performance is better. Due to explicit or implied concentration of power among family members, they are able to take quick decisions in response to market demands. Another benefit is obvious, that promoters are continuously monitoring & protecting assets of the company due to their own stake in the business. On the other hand, modern corporate principally run as a democratic principles. If majority is in favour of a family, they are able to take decisions as they like and in their general interest. The good corporate governance principle requires decisions in favour of interest of company rather than in interest of member or members. More particularly, in circumstances of conflict of interest, human tendency incline to decide in his favour instead of the company. Corporate Governance insists otherwise. In second situation, when, there is a conflict of interest between society (or state) and company, human tendency is to take decision that favours company, corporate governance principles expects otherwise.

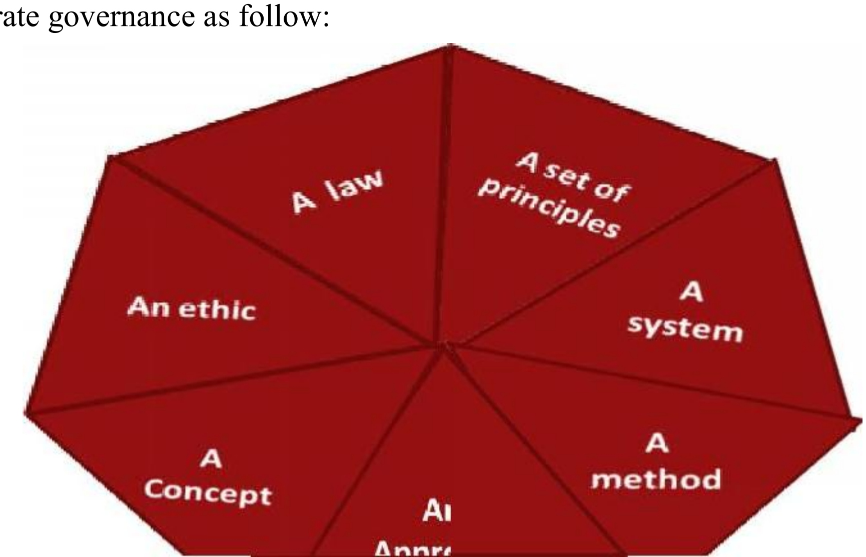


Corporate Governance vis-à -vis Conflict of Interest

This conflict generally happens more frequently & in higher magnitude in family controlled business. Our survey indicates that 80% of business decisions are in contravention of above expected corporate governance norms. 68% of respondents replied that there is severe problem of corporate governance in family based businesses, which are listed in stock exchange.

What is corporate Governance?

Different individuals & bodies define Corporate Governance **(CG)** differently. Our surveyed respondents understood (the total % will be more than 100 as respondent could answer more than one) corporate governance as follow:



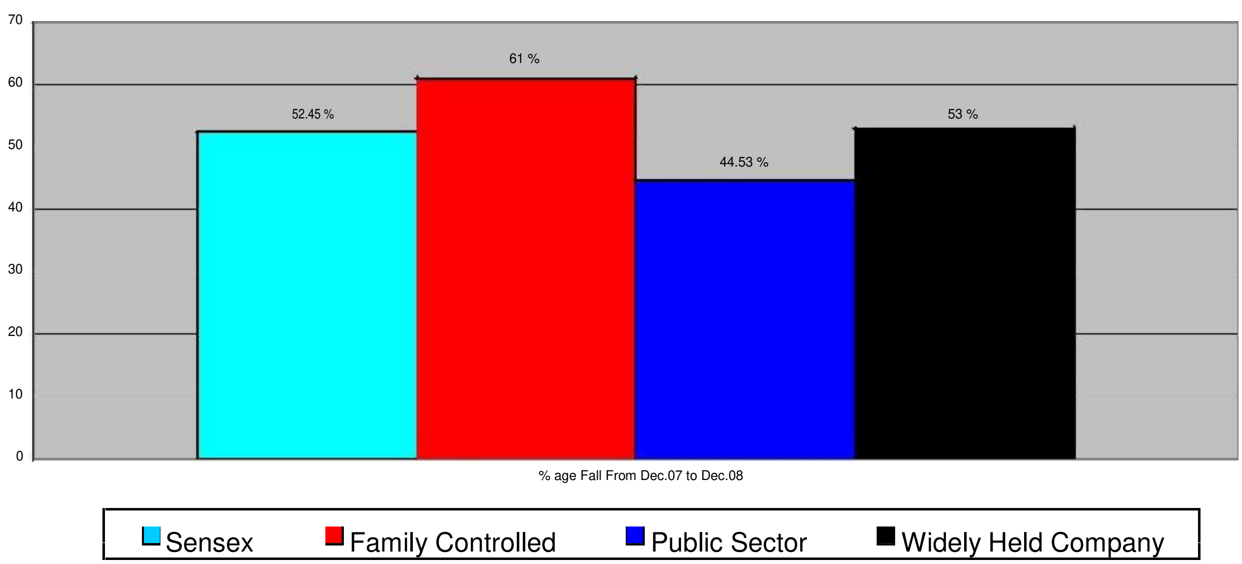
Perception as what is Corporate Governance:

What is CG?	Law	Set of principles	System	Ethic	Concept	Method	Approach
% respondent	61	20	18	34	45	12	9

There are different meanings in mind of investors, auditors & managers as to what corporate governance means and all seems to be valid. But large pool believes that corporate governance is law. Managers believe it as a tool of wealth maximization and hence an approach or a method.

Data Analysis:

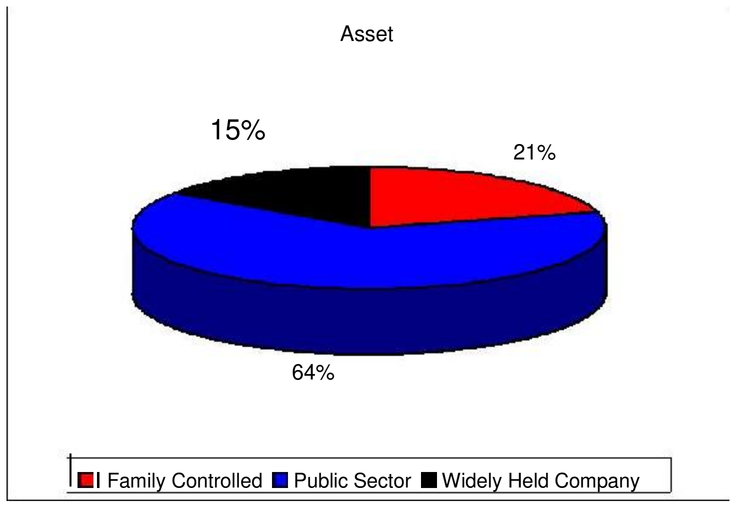
We studied financial & market performance of top 44 Indian companies listed in Forbes Global 2000. The financial performance is related to year ending 2008, and market performance is compared between December 2007 & December 2008. We also studied market performance when the stock prices were on pick vs. bottom. We have classified the data on assets owned by selected 44 companies on the basis of ownership into family based companies (FBC-19), Public Sector Units (PSU-18) and widely held other than family based & PSU (OWC-7) for year 2007-08. The year 2008 remained highly volatile and in January 2008, the SENSEX (Bombay Stock Exchange Index) went on 21200 as the pick, while it was nose-dived in October 2008 at 7600. It was thus fall of 63%. The SENSEX on 31st December 2008 was 52% compared to last year. The family based business shows fall of 61% during the period. Other OWC has fall of 53% while PSU is the least to suffer, i.e. only 44.53%.



It could be interpreted that market has higher confidence in PSUs while family based business the least. It could also be interpreted that family controlled businesses are influencing in bringing the market up artificially.

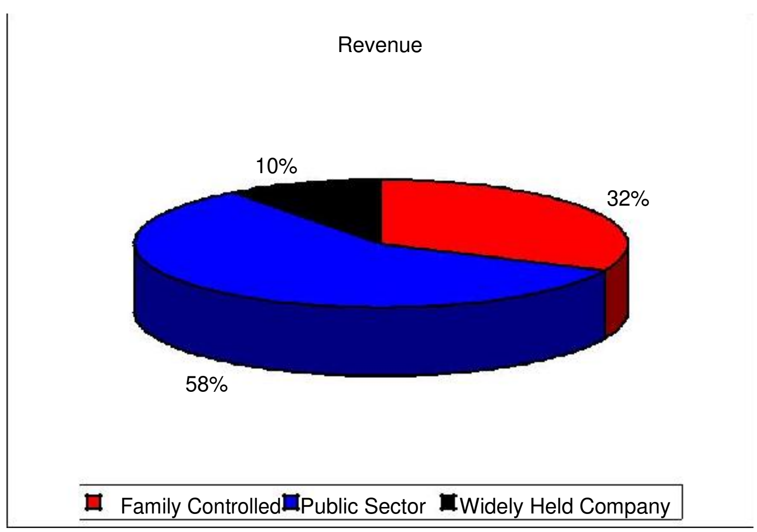
Financial Performance:

It is found that, 64% of the total assets are owned by PSU. While 21% & 19% are owned by FBC & OWC respectively.



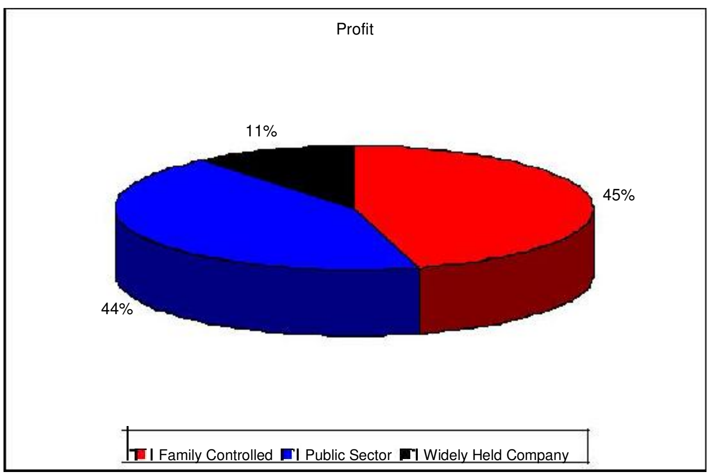
PSU, numbering 18 companies, they hold the highest assets (64%) among total assets held by all 44 companies together. 19 family based company hold 21% assets. This means family controlled business make investment in conservative manner.

Using these assets worth Rs. 858500 million, the selected 44 companies could generate revenue of Rs. 281645 million. 58% of the revenue is generated by PSU while 32% & 10% of the revenue is generated by FBC & OWC respectively.



Using 21% of total assets, family based companies could generate 32% of the sale, while PSU could generate 58% sale by using 64% assets, it means family based businesses are aggressive in employing assets to generate business revenue. It means personal stake in the business made it more efficient in employing assets on use.

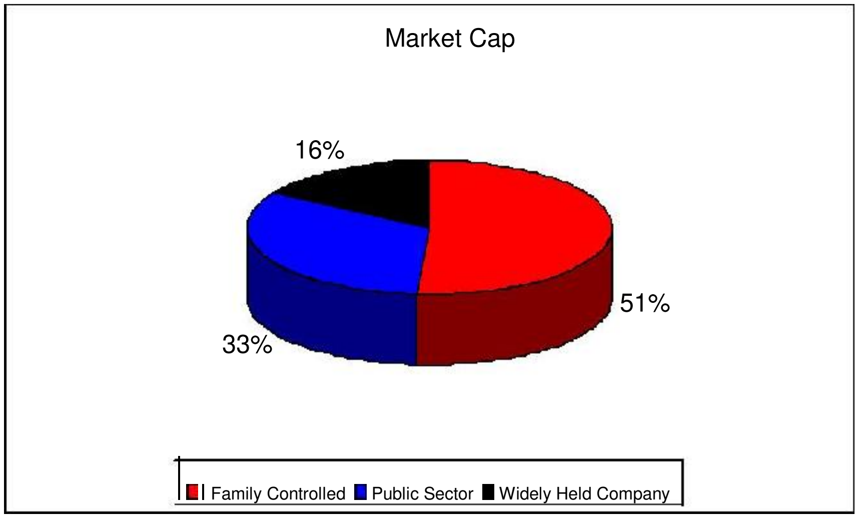
These companies earned profit of Rs. 33313 million. 45% of the profit is earned by FBC while 44% & 11% profit is earned by PSU & OWC. Market cap of these units is approximately Rs. 710119 million, contributed 51% by FBC, 33% by PSU & 16% by OWC. It means FBCs are able to generate better revenue from the unit asset owned by them. Asset Turnover ratio of FBS amounts to 0.51, while that of PSU & OWC is 0.30 & 0.22 respectively. Family Based Companies generated profit as 16.87% of sales and 8.53% of assets by them. PSU could generate profit as 8.90% of sales and 2.65% of assets by them. OWC could generate profit as 12.64% of sales and 2.74% of assets by them.



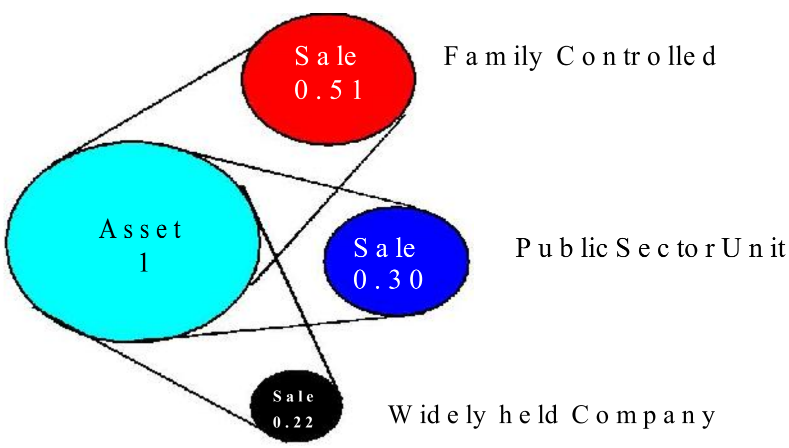
Family based companies are more efficient in terms of restricting the cost or expenses and hence could generate higher profit using unit assets.

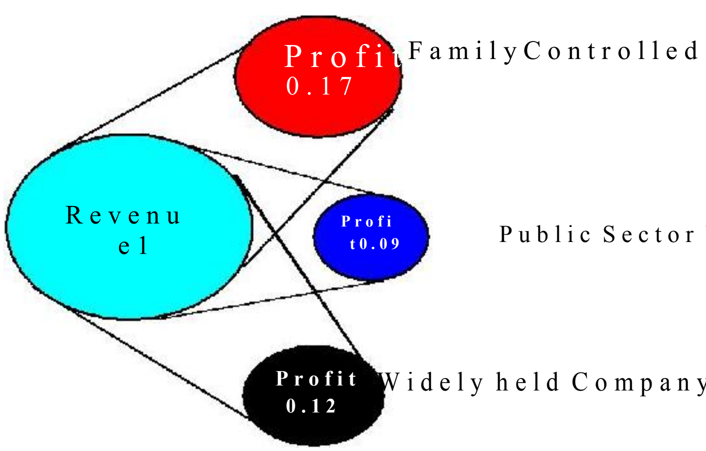
Market Performance:

Year 2008 has been witnessed as unique in terms of market fluctuation. Major index known as SENSEX went up to high as 21206 in January 2008 and lowest as 7697 in October 2008. This indicate fall of 63.74%. There is market fall of 52.45% in SENSEX, comparing December 31, 2007 with that of December 31, 2008. During the same period market fall for FBC was 60.59%, 44.53% in PSU and 52.98% in OWC. Approximately one third of the SENSEX companies are from Family Based Companies. FBC suffered the major loss in the market, in spite higher asset turnover & profitability ratio. PSU suffered the least among all; means with moderate financial ratio, public & investor confidence is high in PSU. Observing the market cap as below mentioned chart, we conclude that family based business work aggressive on increasing market cap that is 51% while PSU market cap is only 33%. FBC are 19 while PSU are 18 in number.



Market cap of FBC is half of total while their assets are 21%. Using a unit of assets family based business could generate 0.51 unit of sale, but failed to win investor confidence in the market. PSU could generate 0.30 unit of sale per unit of asset but shown higher market confidence. OWC could generate 0.22 unit of sale, being moderate among all three type of business.





Thus, the study shows that family based business has strong tendency to increase market cap, inflating share prices in the secondary market and aggressive use of assets and more cost effective. However this study has a limitation on type of industries in each sector, and has different composition in any one sector, e.g. there are more number of banks under PSU. FBC inflates stock prices are reflected during 2008 fall in the stock prices.

Legal Framework to implement Corporate Governance:

To ensure good corporate governance, historically there is strong legal framework existing in India. But due to globalization, cutthroat competition, IT & media invasion, increasing social expectation, liberalization and political, economical, financial & legal reforms; existing legal framework is at stake and new corporate governance norms are evolving. Indian Constitutional Law of India is the root for direction in implementing good corporate governance. Article 38 directs government to ensure equitable distribution of wealth. The clause state that government should work to prevent concentration of wealth and means of production in a few hands, and try to ensure that ownership and control of the material resources is distributed to best serve the common good.

The structure of ownership of any business determines substantially, how a business is controlled and managed. The ownership structure in modern corporate generally is dispersed between numerous individual & group of individual or institute/s. If business is a company, the management & control vest in the hand of Board of Directors, duly elected by a democratic process as set up by the law. Due to various reasons, all shareholders are not participating in electing members of the board. The board members influence in setting & achieving objectives of the company and enjoy power of using companies' resources as they like within limits prescribed by Article & Memorandum of Association & Companies Act. Company has to follow mandates of relevant Accounting Standards in preparing & reporting Financial Statements. Company Act provides provisions relating to special procedure when there is conflicting interest of members of the Board or top management with the interest of the company. If the company is listed in any stock exchange, it has to further follow provisions of clause 49 of SEBI listing agreement. SEBI also ensure shareholder protection by various checks and preventing undue advantage of insider information and unfair takeovers. Financial Statements are the best indicators to report how corporate governance principles are executed. These statements are prepared on the basis of Generally Accepted Accounting Principles (GAAP). Accounting Standards prescribes recognition, valuation, reporting & disclosure of financial information. Globalization has opened new horizons for business to expand its operation but at the same time global transactions has new challenges to encounter. The parties to the business transaction many times take undue advantages from international business. Transaction amongst associate concerns & relatives require special scrutiny. Income Tax Act has enacted provisions to assess true value of the transaction by incorporating principles of Transfer Pricing.

By and large express provision for corporate governance exists for listed companies only. There are no special provisions for family controlled companies. In year 2007, Central Government issued guidelines on corporate governance for central public enterprises. It is voluntary in nature and there are no similar guidelines for state controlled public sector units as such. Similarly clause 49 applies to the listed companies and there are no express provisions on corporate governance issues for un-listed companies how so big it is. Companies Act, 1956 have implied provision that has bearing on corporate governance that applies to all class of companies. Non-companies, how so big in operation & important it is to the public have no similar provisions for corporate governance norms. Accounting Standards issued by ICAI have control over its members if they fail to comply in his audit report. But ICAI has no authority to act against enterprise per se violating Accounting Standards norms. However, the accounting standards prepared and issued by the ICAI were mandatory only for its members, who, while discharging their audit function, were required to examine whether the said standards of accounting were complied with. With the amendment of the Companies Act, 1956 through the subsequent amendment in 1999 & specifying rule in 2006, Accounting Standards are now indirectly integral parts of the Companies Act, which will provide statutory backing. It says that every company and its auditor shall comply with the Accounting Standards in the manner specified in the rules. The Accounting Standards shall be applied in the preparation of General Purpose Financial Statements. Sec. 211 says that

The Government of India recognizing the importance of financial reporting in providing essential financial information about the company to its shareholders and other stakeholders, as an integral and important part of good corporate governance. Such information needs to be reliable, free from bias and should enable comparison on the basis of common benchmarks. This, in turn, necessitates an appropriate, financial reporting system in the form of accounting standards that incorporate sound accounting principles and reflect a true picture of the financial health of the company while ensuring legally enforceable accountability.

The following table provides brief information on the provisions that are directly or indirectly relevant for good corporate governance, along with the consequences of violation of the particular provision.

Table – 1
Legal Framework for Corporate Governance in India

The Legislation	Provision	Penalty	Remark
The Constitutional Law of India	Article 38 & 39, The government is directed that the ownership & control of the material resources are so distributed as to conform to the common good & operation of the economic system does not result into concentration of wealth & means of production to the common detriment	It is source of legislation to enact rules to conform directions given by constitution and by such rules, if fundamental right of a person is violated, courts give priority for common interest	There is no direct bearing on corporate governance issues or on any person
Companies	Sec. 59, If any prospectus is issued in	Punishable with	

Act, 1956 contra	vention of section 57 or 58, the company, and every person, who is knowingly a party to the issue thereof, shall be punishable with fine which may extend to fifty thousand rupees	imprisonment for a term which may extend to five years, or with fine which may extend to one hundred thousand rupees or with both	
	Sec. 63, Criminal liability for misstatements in prospectus, Where a prospectus issued includes any untrue statement, every person who authorized the issue of the prospectus	Punishable with imprisonment for a term which may extend to one/two year, or with fine, or with both	
	68. Penalty for fraudulently inducing persons to invest money		
	105. Penalty for concealing name of creditor, etc.		
	Sec. 162 provides penalty for contravention of not filing annual return & statement as prescribed	Punishable with fine which may extend to five hundred rupees for every day during which the default continues	
	Sec. 211 (3A) Every profit and loss account and balance sheet of the company shall comply with the accounting standards. (3B) Where the profit and loss account and the balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and balance sheet, (a) the deviation from the accounting standards; (b) the reasons for such deviation; and (c) the financial effect, if any, arising due to such deviation. Section 217 sub section (2AA) inserted by the Companies Amendment Act, 2000 states that The Board's report shall also include a Directors' Responsibility Statement indicating therein (1) that in preparation of annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departure	The statutory auditors are required to make qualification in their report in case any item is treated differently from the prescribed Accounting Standard. In addition to this Section 227(3)(d) of Companies Act, 1956 requires an auditor to report whether, in his opinion, the profit and loss account and balance sheet are complied with the accounting standards referred to in Section 211(3C) of Companies Act, 1956.	

	Sec. 225 deals with Statutory Audit of a company, company require to take certificate of auditor that certify financial statement as true & fair Auditor ensures financial statement is the result of financial transaction recorded and reported as per GAAP Sec. 232 provides penalty for not complying with preparing, presenting, submitting/filing audit report as prescribed u/s 225-231	The company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees	
	Sec. 279 prescribe penalty for holding directorship in more number of companies than prescribed	For each additional company in which he is director, Rs. 50000	
	Sec. 297 prescribe taking sanction of the Board of company if a director has interest in certain contract with the company Sec 299 provide responsibility of a director to disclose his interest in the contract with the company Sec. 300 states that the interested director can not participate or vote in Board's proceedings	Interested director can not participate in the voting in Board meeting for the purpose	
	Sec. 371 prescribes penalty for contravention of section 369 (Loans to managing agent), 370 (Loans, etc., to companies under the same management) or 370A, pertaining to intra-company loan or borrowing or creating liabilities like guarantee etc. Sec. 372 prescribes restriction on purchase of share etc. of any company by putting limits	Shall be punishable with fine which may extend to fifty thousand rupees or with simple imprisonment for a term which may extend to six months	
	Sec. 628, 629 prescribes penalty for false statements or false evidences	Punishable with imprisonment for a term, which may extend to two/seven years, and shall also be liable to fine.	
Security Contract Act, 1956	Contracts of security trade in designated area, time, licensing, to deal with recognized dealer, through stock exchange etc. Contract otherwise than this may be void	Punishable with imprisonment for a term which may extend to one year, or with fine, or with both, authority is empowered to de-list a	

		company	
SEBI: Listing Agreement, Clause 49	Composition of Board (at least half should be non-executive, independent), Non executive directors' compensation and disclosures, board meetings (minimum 4 in a year), ceiling on director's membership in committees (maximum 10), ceiling chairman of committees (maximum 5), Audit Committee chairman should be independent director, 2/3rd members should independent & finance or accounting expert, applicability of code of conduct over Board members & top management, appointment of independent director as director of a subsidiary company, procedure to assess risks & disclosures thereof, CEO & CFO certification of financial statement, report on corporate governance compliance	Company may be de-listed from stock exchange	
SEBI: Takeover & Insider Trading, Shareholder Protection etc.	Four prone control/ penal provisions: Directions in investor interest, Adjudication Proceedings, Criminal Prosecution, Enquiry Proceedings Any person who, directly or indirectly, acquires or agrees to acquire shares or voting rights in the target company, or acquires or agrees to acquire control over the target company, either by himself or with any person acting in concert with the acquirer shall inform on crossing 5% or 10% or 14%, 54% and 74% inform Target Company and Stock Exchange within 2 days, Persons holding between 15% & 55%, to disclose purchase or sales aggregating to 2% or more, within 2 days to target company and the stock exchanges, open offer to purchase at least 20% of share at same price if holding cross 15%. Ban on using inside information for personal gain by way of purchase or sale securities for those who have access of internal information	Penalty of Rs. 100,000 per day of continuing violation, penalty is 3 to 5 time of undue gain or advantage, Violation may leads to freeze of transfer of share, voting rights, debarring from access to capital markets, forefeet escrow money, imprisonment up to 10 years and penalty of Rs. 2.5 million in criminal offenses	
Accounting	• AS-1 Disclosure of Accounting	Clause (6) Part I, Second	

Standards (AS) issued by ICAI (Institute of Chartered Accountants of India)	Policies • AS-14 Accounting for Amalgamations • AS-17 Segment Reporting • AS -18 Related Party Disclosures • AS-21 Consolidated Financial Statements • AS-23 Accounting for Investments in Associates in Consolidated Financial Statements • AS-27 Financial Reporting of Interests in Joint Ventures Sec. 227 (3d) whether, in opinion of the auditor, the profit and loss account and balance-sheet comply with the accounting standards referred to in sub-section (3C) of section 211; he may qualify his report and note observations or comments of the auditors which have any adverse effect on the functioning of the company	Schedule of the Chartered Accountants Act, 1949, provides that, failure of an auditor to report a known material mis-statement in the financial statements of a company, with which he isconcerned ina professional capacity, shall be deemed to be 'professional misconduct' ICAI may tale action against auditor only	
Indian Penal Code	Sec. 120B (Criminal conspiracy) 406, 409, 420, 468, 471, 477A relating to fraud, cheating public, creating false documents, duping money etc.	Imprisonment up to 10 years	
Income Tax Act 1961	Regulations (2002) contained the mechanism to ensure that income arising out of international transactions between related parties (associated enterprises) is computed on the basis of arm's length.	Authorizes the assessing of officer to refer the process of determination of arm's length price to the transfer pricing officer amounts to reassessment	

Execution of Legal Framework:

There are series of legislation measures, but there is no vigilant monitoring agency to bring on surface irregularities observed at any layer. There are various layers of executives, various agencies, but there is no coordination among them. In spite of several provisions, hardly few come to the notice of executives and even handful out of them are prosecuted. A note by Bombay Stock Exchange (BSE) said, out of the 2,693 actively-traded companies where Clause 49 is applicable, approximately 18% have either not reported or have reported non-compliance for the quarter ended June 2006. Currently, 4,751 companies are listed on BSE. SEBI receives quarterly reports from Stock Exchanges regarding compliance with Clause 49 of the listing agreement. Clause 49 deals with corporate governance by companies listed on the exchanges. Based on these reports, SEBI has initiated adjudication proceedings only against a total of 20 companies. Among adjudicated companies, five companies are public sector companies against whom proceedings have been launched for non-compliance with provisions relating to Board composition. Out of these 15 private sector companies, proceedings have been initiated against three companies for non-compliance with almost all the major provisions of Clause 49, against two companies for non-compliance with provisions like Board/Audit committee composition and CEO/CFO certification, while for the balance 10 companies, proceedings have been initiated for non-submission of compliance reports on Clause 49 to the Stock Exchanges. The Securities and Exchange Board of India (SEBI) has initiated 'adjudication proceedings' against 20 companies for not complying with the Clause 49 provision of the listing agreement pertaining to corporate governance. Such action would involve imposing monetary penalties on the companies in question. This is the first time the market regulator has formally acted against companies for not adhering to the provision, which defines certain corporate governance rules for listed companies including board composition. Out of the 15 private sector companies, action has been initiated against three companies for non-compliance with almost all the major provisions of Clause 49. Two companies have not complied with provisions like board/audit committee composition and CEO/CFO certification, while the rest have not submitted compliance reports on Clause 49 to stock exchanges. The action against the state-owned companies has been initiated for non-compliance with provisions relating to board composition.

The Department of Company Affairs prosecuted only 400 companies in 2006. Many of the companies are indulged into serious fraud and vanished with public money. As per department's note, the government suspects many of the companies against prosecution is launched might have vanished after raising money from the public. ''We have issued notices to them. But some of these letters have come back saying 'addressee not found',' ' said a government source. According to market estimates, assuming that each company mobilized an average of Rs 10 crore, these companies might have raised at least Rs 4,000 crore from the capital market. Besides, at least Rs 1,000 crore of investors' money could be locked up in these companies in the form of fixed deposits and other instruments. There is no reliable research on total stake of family based companies among all companies working in India. But it is believed that more than one third are family controlled business houses. Our study also substantiates these figures as outlined elsewhere in this report.

There are enough provisions in the Companies Act, 1956 & Indian Penal Code to penalize errant directors and officers, major problem lies in the fact that most of the provisions are in the statute book, rarely used and mostly misused or abused. Executing these provisions till adjudication ends is time consuming and hence its deterrent effect diminishes. Court procedures are highly cumbersome & slow. Few prosecution take place out of those reported for irregularities. There is no record how many violations go unrecorded. The solution therefore is to ensure proper corporate governance execution, monitoring, control and report deviation within stipulated time. There is strong need to make regulating institutions and laws functional. Another problem that make legal system ineffective, the courts are taking long time to dispose the case. Over a period of time and passing of the long time, the documents, witnesses, records are not available so evidences become weak, and offenders escape un-penalized.

There is no effective machinery to monitor implementation of corporate governance rules, whether they are observed or not on one hand while on other hand in large number of offenses, penalty is very small compared to gravity of offense and benefit grabbed by offender.

Satyam Computer Fraud – Greatest Corporate Governance Failure:

As discussed above, we surveyed 300 respondents to know their perception on corporate governance practices. The respondents chosen were comprised of investors, auditors, finance & legal experts and M.B.A. students. The 68% respondents responded that family based companies are violating corporate governance norms as prescribed by clause 49 of SEBI. We found from that respondents and substantiated from available literature that at least following firms are under public scanner and doubtful in observing good corporate governance norms. They include: Birla group (Priyamvada Birla & Lodha), Reliance group, India Bulls, Satyam Computers and Ranbaxy Laboratories.

We probed the Satyam Computer Company fraud in light of above legal provisions and found that in spite of series of legislation, the so called big IT company can violate and can violate at this magnitude and that too for long period of time! We first narrate the brief facts of the case and have attached (Annexure-III) letter written by former Chairman of Satyam Computers confessing the crime. Satyam Computer Services Ltd. was founded in 1987. The company is engaged in information technology (IT) services spanning various sectors, and is listed on the New York Stock Exchange and Euronext. Satyam's network covers 67 countries across six continents. The company employs 53,000 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 serves over 654 global companies, 185 of which are Fortune 500 corporations. Satyam has several subsidiaries and group companies. Most controversial is Maytas Infrastructure. Satyam failed in acquiring interest in its associate concern, which is engaged in altogether different business line. Maytas is controlled by Raju Ramalinga (The Chairman till 7th January 2009) and majority shareholders are family members of Raju.

The meaning of Satyam is truth. The fact is reverse than what it actually means! In a shocking letter, Mr. Raju confessed that the actual cash (Rs. 321 crore) was only 5% of what was shown (Rs. 5361 crore) on the Balance Sheet. It is shocking that how top global accounting firm PriceWaterhouseCooper signed Satyam's Financial Statements for couple of years and how regulators in India, Europe and the United States apparently failed to pick up any whiff of problems. However Chairman denied that no other member of the Board or Family is involved or knowing the fact. It is in fact unbelievable that such a fraud can be carried for long time without knowledge of key personnel. Either they are part of conspiracy or gross negligence. The second reason is hard to trust as so called independent directors are big experts. Either independent directors have failed in their role as independent director or are per se inefficient. There was understated liability of Rs. 1230 crores, beside non-existent accrued income of Rs. 376 crore. In the last quarter that was ended on September 30, 2008, actual profit margin was Rs. 61 crore, while it was shown on audited statement as Rs. 649 crore!. There were several items, which were fake per se. In fact the fraud shown may be even more serious than confessed, only investigation and future can tell the real picture.

After his confession on 7th January 2009, the prosecuting agencies have arrested Mr. Raju on 9th January and the Board members are suspended. New York stock exchange suspended the business in Satyam Securities.

Apart from the charges leveled by Indian government, investors in USA have filed lawsuit. Before the scam on surface, World Bank banned the errant firm from business for seven years. World Bank alleged theft of data, violation of terms of business and indulging in bribe. Satyam also faced several lawsuits including one filed in April 2007, by Upaid, in the Texas court against Satyam—India's fourth largest computer services company—alleging fraud, forgery, misrepresentation and breach of contract involving transfer of intellectual property rights issues arising from a project the firms jointly worked and asked to compensate for $1 billion.

Satyam faced a serious management credibility crisis since chairman B. Ramalinga Raju led a move to use $1.6 billion (Rs7,760 crore) of Satyam's money to buy two infrastructure firms owned by his family members under the pretext of diversification. The recent crisis surfaced when Satyam Computer Services Ltd proposed to acquire stake in a company related to its promoters but unrelated to its core competency. The company under question named as reverse letter of SATYAM, known as MYTAS is engaged in infrastructure. Board that included independent directors approved it. In Indian language, Satyam means truth! and its reverse lies!! This has called into question the role of independent directors on the board. The widespread anger forced to put off the acquisition. Shareholders, who rely on the presence of such directors to provide the balance against transgressions of governance, must now be wondering whether there are other instances, which pass unnoticed. Company's independent directors included the biggies. There is crisis of public confidence in business, auditors, lawmakers & executing agencies. By any yardstick, these are men of eminence and learning who should be independent. Yet this fiasco took place on their watch. One can well imagine the Securities and Exchange Board of India and the US Securities Exchange Commission wondering, if a board so exalted could not protect the interests of minority shareholders, what can one hope for governance at all. The basic question is, to what an extent, independent director is really independent in decision-making process? The composition of the board itself is largely influenced by the likes and dislikes of the chief executive officer, and hence the spirit of appointing independent director as part of good corporate governance serves no basic purpose to get directions in the overall interest of the company.

The question that raises doubt is over auditors. How a statement certified by an auditor one can rely if Financial Statement can be inflated to such an extent? It is a failure of corporate governance system at each layer, whether within company or outside the company, whether expert like auditors or executives, whether interested or independent directors.

Conclusion:

Family based businesses are part of overall business scenario & indispensable. Family based businesses are engine of growth. Due to personal stake of promoters and involvement in the business, if they themselves manage the business, promoters are able to generate more revenue, more profit & more wealth. Family based business react very quickly to the market demand, hence could capture the large share of market. In the race of the greed, they are working more efficiently & in better way. In corporate businesses, if a particular family is in control, the management may misuse power vested in them as member of the board. This may result into undue benefit to the related parties and violation of corporate governance norms. Blood is thicker than water.

The current accounting and auditing system is not capable to fully protect interest of all stakeholders. The regulatory authority is also ill equipped either by powers, skills or will. The monitoring agencies are not functioning to the mark. The legislations and provisions are multiple and are vague in nature. There is no coordination between different agencies like SEBI, RBI, Department of Company Affairs etc. Penalties are small in many offenses, e.g. if a director, there does not show conflict of interest is penalty is of Rs. 500 only, if auditors fail to qualify a report, then ICAI can take action against auditors. If provisions of Accounting Standards are not followed, auditor can merely make remark, which goes un-noticed for the shareholders. Shareholders are not literate, expert in financial matters or some time simply not interested. Shareholders elect directors by majority who are present in Annual Meeting. Only few shareholders are remaining present in the meeting and even very few raise questions during the meeting. Independent directors are not independent by spirit but influenced by the top executives. In the situation, corporate governance norms are not observed at various stages, and those are interested or responsible to implement fails to understand long-term impact of such violations.

Suggestions:

1. There must be continuous vigilance over all widely held company, where public is substantially interested.
2. There must be clear & identifiable authorities, which should be made accountable in case of failure and should take speedy & strict actions.
3. Vigilance officers must be given training on how to identify & check frauds.
4. The penalty & punishment should be deterrent and of higher amount.
5. There must be provision of recovery of grabbed amount from the property created and transferred to any person or in any other form.
6. There must be speedy disposal of disputes, investigation, prosecution and adjudication process.
7. There must be coordination between different authorities working for different purposes.
8. There must be special corporate governance norms for family based business houses
9. Family based businesses should be made more transparent, accountable and subject to higher surveillance
10. Clause 49 should give wide powers to Audit Committee
11. Clause 49 should have penal provision in case of failure
12. Whistle blowers must be protected and promoted by compensating if information is correct & useful

Abbreviations & Glossary:

Lacs = One hundred thousand (one tenth of a
million) Crore = One hundred lacs (10 million)
BSE – Bombay Stock Exchange
CFO – Chief Financial Officer
CEO – Chief Executive Officer
DCA - Department of Company
Affairs FBC – Family Based Company
GDP – Gross Domestic Product
ICAI – Institute of Chartered Accountants of India
OWC – Other Widely Held Company (other than FBC & PSU)
PSU – Public Sector Unit (where 50% or more share is held by one or more government)
RBI – Reserve Bank of India
SEBI – Security Exchange Board of India
Widely Held Company – as defined by Income Tax Act 1961

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Annexure-I
Indian Industry Ranking (Forbes)

Figure: $ Million

Rank	Company	Industry Type	Sales	Profits	Assets	Mkt Value
1	Reliance Industries	Oil & Gas operations	26071	2794	30669	91539
2	ONGC	Oil & Gas operations	18896	4112	33795	61811
3	State Bank of India	Banking	15774	1473	188565	24097
4	NTPC	Utilities	7839	1596	20335	45262
5	ICICI Bank	Banking	9836	639	91070	25003
6	Indian Oil	Oil & Gas operations	42684	1821	25394	13095
7	SAIL	Materials	7881	1450	8049	24676
8	Tata Steel	Materials	5829	967	11475	13776
9	Bharti Airtel	Telecommunication	4262	940	6607	48170
10	Reliance Commu.	Telecommunication	3132	654	13080	39010
11	Tata Consultancy	Software	4324	975	3035	26302
12	Sterlite Industries	Materials	5643	1038	5553	15567
13	BHEL	Capital Goods	3989	559	5175	28364
14	Infosys Tech.	Software	3215	892	3082	27173
15	L & T	Capital Goods	4683	518	5718	23831
16	Wipro	Software	3471	681	3262	18138
17	Bharat Petroleum	Oil & Gas operation	22774	496	8675	3188
18	PNB	Banking	3032	377	38419	4086
19	ITC	Food Drink & Tobacco	2977	638	3567	17583
20	HDFC	Banking (Housing)	1487	402	16967	17645
21	Canara Bank	Banking	3030	354	38538	2820
22	Tata Motors	Capital Goods	7267	502	5775	7750
23	GAIL (India)	Utilities	3825	589	5027	8719
24	Hindustan Petrol.	Oil & Gas operation	20479	387	7586	2005
25	Hindalco Ind.	Materials	4407	622	6434	4874
26	DLF	Construction	5532	2590	19655	33586
27	Grasim Industries	Construction	3237	455	3699	8560
28	HDFC Bank	Banking	1958	266	21093	11734
29	Bank of Baroda	Banking	2547	261	33975	2668
30	Hindustan Unilever	Household/ Personal care	2797	427	1609	11994
31	Maruti Suzuki	Auto, Consumer durable	3407	368	2398	8049
32	Bank of India	Banking	2481	256	32796	3875
33	Mahindra & Mahi.	Auto, Consumer durable	4074	346	4593	4655
34	IDBI	Banking	1703	136	24514	2529
35	Union Bank of India	Banking	1903	196	23760	1984
36	Unitech	Construction	761	302	3029	13802
37	Central Bank of India	Banking	1577	118	21441	1309
38	Syndicate Bank	Banking	1541	166	20659	1134
39	Indian Overseas Bank	Banking	1432	233	19034	1784
40	UCO Bank	Banking	1347	73	17324	829
41	Satyam Computer	Software	2323	452	2306	1200
42	Ranbaxy	Pharmaceuticals	4532	612	6041	2538
43	Suzlon	Windmills				
44	India Bulls	Real Estate	1686	580	14722	3405

Annexure-II

Detail of Stock Index Movement of leading Indian Companies

No.	Rank	Company	Highest	Lowest	31.12.2007	31.12.2008	Difference
		SENSEX*	**21206**	**7697**	**20287**	**9647**	**-10639**
1	9	Bharti Airtel	1010	484	995	715	-280
2	13	BHEL	2626	984	2584	1362	-1222
3	26	DLF	1225	158	1074	282	-792
4	27	GRASIM	3830	831	3651	1218	-2433
5	28	HDFC Bank	1825	800	1728	997	-731
6	30	Hind Unilever	267	170	214	250	36
7	25	HINDALCO	221	38	215	51	-164
8	20	HDFC	3257	1202	2872	1487	-1385
9	19	ITC	239	132	210	171	-39
10	5	ICICI	1465	282	1232	448	-784
11	14	Infosys	2017	1040	1768	1118	-650
12	15	L & T	440	670	2172	774	-1398
13	33	M & M	368	170	322	253	-69
14	31	Maruti Suzuki	872	235	861	275	-586
15	4	NTPC	291	113	250	181	-69
16	2	ONGC	1356	538	1236	252	-174
17	10	Reliance Commu.	844	148	746	227	-519
18	1	Reliance Industries	3252	930	2881	1230	-1651
19	3	SBI	2540	991	2371	1288	-1083
20	12	Sterlite	1085	164	1035	261	-774
21	22	Tata Motors	816	122	742	159	-723
22	8	TISCO	952	146	935	217	-718
23	11	TCS	1078	418	1083	478	-605
24	16	Wipro	538	182	525	233	-292
25	6	Indian Oil	801	419	744	430	-314
26	7	SAIL	294	79	282	79	-203
27	40	UCO Bank	88	22	58	31	-27
28	29	Bank of Baroda	491	291	454	279	-175
29	35	Union Bank	230	166	208	167	041
30	39	Indian Overseas Bank	200	77	180	84	-96
31	38	Syndicate Bank	127	66	116	67	-49
32	18	PNB	711	515	680	533	-147
33	37	Central Babk of India	154	32	123	48	-75
34	21	Canara Bank	412	211	315	218	-97
35	32	Bank of India	388	302	366	302	-64
36	34	IDBI	180	53	175	55	-120
37	17	Bharat Petroleum	552	356	475	387	-88
38	23	GAIL (India)	366	204	357	215	-142
39	24	Hindustan Petroleum	404	261	376	276	-100
40	36	Unitech	534	45	490	48	442
41	-	Satyam	544	114	449	170	-279
42	-	Ranbaxy	427	245	421	251	-170
43	-	Suzlon Industries	405	66	386	67	-319
44	-	India Bulls	1025	145	997	147	-850

*SENSEX – Security market index at Bombay Stock Exchange

Annexure-III

To the Board of Directors

Satyam Computer Services Ltd.

From B. Ramalinga Raju

Chairman, Satyam Computer Services Ltd. January 7, 2009

Dear Board Members,

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:

1. The Balance Sheet carries as of September 30, 2008
   a. Inflated (non-existent) cash and bank balances of Rs.5,040 crore (as against Rs. 5361 crore reflected in the books)
   b. An accrued interest of Rs. 376 crore which is non-existent
   c. An understated liability of Rs. 1,230 crore on account of funds arranged by me
   d. An over stated debtors position of Rs. 490 crore (as against Rs. 2651 reflected in the books)

2. For the September quarter (Q2) we 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.

The gap in the Balance Sheet has arisen purely on account of inflated profits over a period of last several years (limited only to Satyam standalone, books of subsidiaries reflecting true performance). 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 significantly (annualized revenue run rate of Rs. 11,276 crore in the September quarter, 2008 and official reserves of Rs. 8,392 crore). The differential in the real profits and the one reflected in the books was further accentuated by the fact that the company had to carry additional resources and assets to justify higher level of operations –thereby significantly increasing the costs.

Every attempt made to eliminate the gap failed. As the promoters held a small percentage of equity, the concern was that poor performance would result in a take-over, thereby exposing the gap. It was like riding a tiger, not knowing how to get off without being eaten.

The aborted Maytas acquisition deal was the last attempt to fill the fictitious assets with real ones. Maytas' investors were convinced that this is a good divestment opportunity and a strategic fit. Once Satyam's problem was solved, it was hoped that Maytas' payments can be delayed. But that was not to be. What followed in the last several days is common knowledge.

I would like the Board to know:

1. That neither myself, nor the Managing Director (including our spouses) sold any shares in the last eight years – excepting for a small proportion declared and sold for philanthropic purposes.

2. That in the last two years a net amount of Rs. 1,230 crore was arranged to Satyam (not reflected in the books of Satyam) to keep the operations going by resorting to pledging all the promoter shares and raising funds from known sources by giving all kinds of assurances (Statement enclosed, only to the members of the board). Significant dividend payments, acquisitions, capital expenditure to provide for growth did not help matters. Every attempt was made to keep the wheel moving and to ensure prompt payment of salaries to the associates. The last straw was the selling of most of the pledged share by the lenders on account of margin triggers.

3. That neither me, nor the Managing Director took even one rupee/dollar from the company and have not benefitted in financial terms on account of the inflated results.

4. None of the board members, past or present, had any knowledge of the situation in which the company is placed. Even business leaders and senior executives in the company, such as, Ram Mynampati, Subu D, T.R. Anand, Keshab Panda, Virender Agarwal, A.S. Murthy, Hari T, SV Krishnan, Vijay Prasad, Manish Mehta, Murali V, Sriram Papani, Kiran Kavale, Joe Lagioia, Ravindra Penumetsa, Jayaraman and Prabhakar Gupta are unaware of the real situation as against the books of accounts. None of my or Managing Director's immediate or extended family members has any idea about these issues.

Having put these facts before you, I leave it to the wisdom of the board to take the matters forward. However, I am also taking the liberty to recommend the following steps:

1. A Task Force has been formed in the last few days to address the situation arising out of the failed Maytas acquisition attempt. This consists of some of the most accomplished leaders of Satyam: Subu D, T.R. Anand, Keshab Panda and Virender Agarwal , representing business functions, and A.S. Murthy, Hari T and Murali V representing support functions. I suggest that Ram Mynampati be made the Chairman of this Task Force to immediately address some of the operational matters on hand. Ram can also act as an interim CEO reporting to the board.

2. Merrill Lynch can be entrusted with the task of quickly exploring some Merger opportunities.

3. You may have a 'restatement of accounts' prepared by the auditors in light of the facts that I have placed before you.

I have promoted and have been associated with Satyam for well over twenty years now. I have seen it grow from few people to 53,000 people, with 185 Fortune 500 companies as customers and operations in 66 countries. Satyam has established an excellent leadership and competency base at all levels. I sincerely apologize to all Satyamites and stakeholders, who have made Satyam a special organization, for the current situation. I am confident they will stand by the company in this hour of crisis.

In light of the above, I fervently appeal to the board to hold together to take some important steps. Mr. T.R. Prasad is well placed to mobilize support from the government at this crucial time. With the hope that members of the Task Force and the financial advisor, Merrill Lynch (now Bank of America) will stand by the company at this crucial hour, I am marking copies of this statement to them as well.

Under the circumstances, I am tendering my resignation as the chairman of Satyam and shall continue in this position only till such time the current board is expanded. My continuance is just to ensure enhancement of the board over the next several days or as early as possible.

I am now prepared to subject myself to the laws of the land and face consequences thereof.

(B. Ramalinga Raju)

Copies marked to:

1. Chairman SEBI
2. Stock Exchanges