SAL Wroclaw

Lectures on Corporate Governance

Session 8
Case Study
Corporate Governance in Emerging Markets

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Corporate Governance in Asia / Asian Emerging Markets

Japan – *keiretsu*

South Korea – *chaebol*

India – family-owned businesses

Family-owned Businesses

"Worldwide, as in India, family owned businesses have survived multiple generations. What is more, they have grown to become multi-billion dollar corporations and continue to make significant contributions to the economy.

The oldest family-owned business still in operation is the Japanese construction company, Kongo Gumi, founded in 578 AD. It is currently managed by the 40th generation!

There are more than 100 family businesses that are more than 200 years old. Many family businesses have attained considerable size too. The largest retail company in the world, WalMart is a family business.

Family owned businesses have played a crucial role in the economy of most countries. Much of the retail trade, small scale industry and the service sector are run by family business.

Further, family managed businesses employ half the world's workforce and generate well over half the world's GDP. In the United States, 24 million family businesses employ 62 percent of the workforce and account for 64 percent of the GDP.

In India, it is estimated that 95 percent of the registered firms are family businesses."

Source: Are joint family owned business disintegrating?, *Asian Tribune*, Wednesday, March 21, 2007

Family-owned Businesses - India

"Family enterprises existed in India since as long ago as recorded history. With time, the contribution of family businesses has gone beyond simply paying taxes and employing people. During the last 100 years or so, Indian family businesses have made significant contributions in three areas: the freedom struggle, lowering transaction costs and ensuring broad basing of Indian industrial base.'

The biggest Indian businesses are family businesses of Ambani, Tata, Mittal, Chhabari,Godrej...

Source: Are joint family owned business disintegrating?, *Asian Tribune*, Wednesday, March 21, 2007

Outsourcing

To outsource is:

to transfer the production of a product (Levis jeans or Nike shoes) to a company usually “outside” of the home country “source” of the product;

or

to transfer the conduct of a service (accounting or response to customer inquires) to a company usually “outside” of the home country of the company.

Hollywood – Bollywood
Silicon Valley – Hyderabad

India: Hyderabad, Andra Pradesh

Hyderabad is home to the following Indian IT companies: Satyam, Infosys, Wipro, Patni Computer Systems, Cognizant Technologies, Tata Consultancy Services and Polaris.

It is also home to the following multinational companies:

- **Microsoft (the largest R&D campus outside the US),**
- **Computer Associates, Amazon, GE, IBM,**
- **AMD, Accenture, Google, Motorola,**
- **SAP AG, DuPont, Deloitte, Oracle Corporation,**
- **Dell, Franklin Templeton, Qualcomm,**
- **Agilent, ADP, UBS AG,**
- **Rockwell Collins,**
- **Bank of America,**
- **CSC,**
- **Verizon,**
- **Convergys,**
- **Texas Instruments,**
- **Hewlett-Packard,**
- **Virtusa.**

Source: http://hyderabad-info.greaterhyderabad.co.in/

Satyam

“Satyam (NYSE: SAY) is a leading global business and information technology services company, delivering consulting, systems integration, and outsourcing solutions to clients in 20* industries and more than 65* countries.

Satyam leverages deep industry and functional expertise, leading technology practices, and an advanced, global delivery model to help clients transform their highest-value business processes and improve their business performance. The company’s 52,865* Associates excel in engineering and product development, supply chain management, client relationship management, business process quality, business intelligence, enterprise integration, and infrastructure management, among other key capabilities.

Satyam development and delivery centers in the US, Canada, Brazil, the UK, Hungary, Egypt, UAE, India, China, Malaysia, Singapore and Australia serve 690* clients, including 185* Fortune 500.”

***Figures as of September 30, 2008**

http://www.satyam.com/about/about_us.asp

Ramalinga Raju

Photo: Satyam Chief Admits Huge Fraud, ***New York Times*, Wednesday, January 7, 2009**

Satyam scandal – The admission

"Mr. Raju said last week in a shock admission that he had inflated profits, revenues and margins, and invented most of the group's more than $1 billion cash pile, leading to worries that Satyam might not be able to pay its normal operating expenses."

Source: Minister eases fears over Satyam's cash flow, *Financial Times,* Friday, January 16, 2009

Satyam scandal – The fallout

“The disaster that is Satyam has sent shockwaves around the outsourcing world.

In short, India's fourth-largest outsourcing services provider inflated the amount of cash it said was on its books by $1bn (£680m); incurred a $253m liability on funds personally arranged by its chairman and founder, Ramalinga Raju; overstated quarterly revenues for the period ending 30 September 2008 by 28% and overstated earnings by $125m.

These revelations have led to a crisis of confidence about whether the company will continue, placing question marks over India as a premier destination for outsourcing IT services.

Rebuilding Satyam’s reputation may be a near-impossible task.

Satyam undertakes a variety of IT jobs, which include project-based programming through to running business-critical systems such as those offered by SAP and Oracle.

Source: Satyam scandal – the fallout, Thursday, January 15, 2009 - www.guardian.co.uk

Satyam scandal – The fallout

“Francine McKenna, an ex-PWC director and a fierce critic of the "big four" accounting firms (PricewaterhouseCoopers, KPMG, Deloitte and Ernst & Young), believes the Satyam issue raises fundamental questions of oversight.

She says: ‘It's hard to know the extent to which there was complicity between the auditors and senior management or whether it was plain incompetence. PWC (Satyam's auditors) doesn't have the enforcement capability. It's left with little choice other than to cut off the gangrenous arm and throw some of its Indian partners under the bus.’”

Source: Satyam scandal – the fallout, Thursday, January 15, 2009 - www.guardian.co.uk

Satyam scandal – The second admission

“Satyam CEO B Ramalinga Raju did divert funds from the services company to family-owned Maytas. He confessed it on January 22, 2009 to the police.

Maytas Properties and Maytas Infra, which have both come under scrutiny, are partly–owned by several members of the Raju family, including Raju and his brother Rama Raju, who was MD of Satyam. Both companies have previously denied receiving funds from Satyam.

The alleged confession is in contradiction to Raju’s original statement that THE COMPANY INVENTED $1 BILLION OF ASSETS AND CASH IN ACCOUNTS, AND THAT THE MONEY ONLY EXISTED ON PAPER.

According to the Economic Times a substantial amount of money was used to invest in real estate around Hyderbad. Maytas Properties is belived to have built up a significant portfolio of prime real estate in the city in recent years, including 7,000 acres of land.

Raju is thought to have used a Mauritius – based company to transfer money to Maytas since 2004. The report also claims that the company founder submitted fake bank documents to auditors PWC and created 6,000 fake salary accounts to siphon off additional money from Satyam.”

Source: Satyam boss did divert company funds to Maytas, Thursday, January 22, 2009 www.arabianbusiness.com

THESE ARE ALLEGATIONS ONLY TO BE CONFIRMED IN PROSECUTION.

Satyam scandal – Questions

How can this happen?

Comment on the Satyam scandal, in comparison with the Skandia case.

Who is responsible?

Satyam scandal –
How did the system work?

Indian regulators shake up share rules in wake of Satyam scandal

By Joe Leahy in Mumbai

Controlling shareholders in Indian companies will be forced to reveal borrowings made against their own shares under reforms launched by regulators that could provide more transparency about how India's most powerful business families control their empires.

The move by the Securities and Exchange Board of India to make it mandatory for the controlling shareholders of companies to disclose when they pledge shares as collateral to lenders is the biggest capital reform since the Satyam scandal erupted this month.

"Such disclosures shall be made as and when the shares are pledged as well as by way of periodic disclosures," Sebi said.

The Satyam scandal, in which B. Ramalinga Raju, the founder and then-chairman of India's fourth-largest software group, confessed to fixing the company's books in a fraud worth over $1bn (€775m), came to light after the controlling family pledged its 8 per cent stake to lenders.

When the value of those shares dropped in line with a crash in the Indian market last year, the lenders started liquidating the family stake to realise their collateral, forcing Mr Raju to own up to his fraud before he lost control of the company.

The collapse in Satyam's share price has led to nervousness among many other Indian companies, with more than half of the constituents of the benchmark Bombay Stock Exchange Sensex index owned or controlled by powerful business families.

Investors fear that the controlling shareholders of many companies may have pledged their shares and that their stocks could crash if lenders begin selling. These concerns have helped knock 15 per cent off India's market since the Satyam scandal broke just over two weeks ago.

"This is very positive. The uncertainty will be over," Dharmesh Mehta, head of broking at Enam Securities in Mumbai, said of the Sebi move. "Unfortunately, even those companies who have not been pledging their shares are getting punished right now."

C.B. Bhave, the chairman of Sebi, said controlling shareholders would have to reveal their pledges to lenders at the time of borrowing, as well as every three months. "When any scandal happens, as a system we respond with long-term improvement."

No one knows the extent of borrowings by controlling shareholders, which are often concealed in unlisted holding companies or branches of their opaque group structures.

Source: *Financial Times*, Thursday, January 22, 2009

Satyam scandal –
How did the system work?

Questions:

Explain what is happening.

Diagram the relationships described in paragraphs one, two and four of the article.

Satyam scandal –
How did the system work?

4 FRIDAY - SUNDAY, JANUARY 16 - 18, 2009 THE WALL STREET JOURNAL.

CORPORATE NEWS

Satyam directors questioned purchases

Board minutes show members raised issues on deals for property companies before final approval was given

BY NIRAJ SHETH
AND JACKIE RANGE

NEW DELHI—Minutes from a crucial December board meeting at **Satyam Computer Services Ltd.** shed new light on how the giant outsourcer's directors wound up approving two deals that were a key part of the massive fraud that has since engulfed the company.

The minutes, a copy of which was reviewed by The Wall Street Journal, show that at least three directors asked questions about the proposed $1.6 billion acquisitions. But in the end, the deals were approved by the board after extensive presentations on the merits by senior Satyam management.

The two deals at issue were the acquisition by Satyam of two infrastructure companies—**Maytas Properties Ltd.** and **Maytas Infra Ltd.**—that are run by the sons of the founder and then-chairman of Satyam, B. Ramalinga Raju. Mr. Raju also had a financial interest in the companies.

The deals are significant because they set in motion a chain of events that culminated with Mr. Raju's confessional letter to the board last week that he had cooked Satyam's books for several years, including the creation of a fictitious bank balance in excess of $1 billion.

Mr. Raju said in his letter that

Excerpts from minutes recorded at a Dec. 16 Satyam board meeting that discussed a controversial acquisition proposal:

■ Dr. Mangalam Srinivasan, director, enquired if there are any particular reason[s] either external or internal for this initiative and timing of the proposal. Mr. Ram Mynampati informed about the current down turn and challenging times in the market place.

■ Prof. Krishna Palepu, director, stated that the proposed acquisitions have two complicated aspects – unrelated diversification and related party transactions.

■ Prof. Rao then wanted to know the risks involved in this diversifying strategy. It was mentioned that there may be some risk but it can only be known from the market place.

Key people mentioned...

Mangalam Srinivasan, adviser to JFK School of Government at Harvard. Recently resigned from Satyam board.

Ram Mynampati, recently became ▶ interim CEO of Satyam, before being removed by the government last week.

Krishna Palepu, professor at Harvard Business School. Recently resigned from Satyam board.

M. Rammohan Rao, former Dean of Indian School of Business. Recently resigned from Satyam board.

AFP

lamani. Messrs. Satti and Vadlamani weren't board members.

"This is the time to adopt strategies for de-risking by diversification into different segments," Mr. Mynampati told the board, the minutes show.

Mr. Vadlamani presented the board with valuations on both companies, including one on Maytas Properties prepared by accounting firm Ernst & Young.

Mr. Satti promoted Satyam's expansion into infrastructure, noting that Satyam's "tools, processes and

cial officer, was taken into police custody in the city of Hyderabad last week, arrested on charges of fraud. His lawyers also weren't reachable. He wasn't mentioned by name in Mr. Raju's letter.

In a prepared statement, Ernst & Young said it had provided the valuation for another purpose and was "not given to understand by any party, explicitly or implicitly, during the valuation exercise, about Satyam's plans to acquire Maytas Properties."

Some independent directors

tion] methodology to be adopted," he said, according to the minutes.

Another independent director, Mangalam Srinivasan, said the board should have been involved earlier "to avoid the impression that the board is used as a rubber stamp." When Mrs. Srinivasan asked why the company was proposing the acquisition now, Mr. Mynampati told her the downturn in the technology industry made it "the right time to de-risk."

A person familiar with the meeting said management also raised

ment. Mr. Rao and Mrs. Srinivasan also couldn't be reached. The three directors resigned in December, without publicly citing reasons.

Mr. Palepu, who also resigned from the board in December, said in a statement Thursday that after the meeting he made recommendations to the board and management about steps to get the company back on solid footing, citing steps such as reconstituting the board and hiring an outside financial adviser.

He said that to get the company back on its feet, board members would have to spend much more time in the country for meetings and discussions, which he couldn't commit to. "This realization was what drove my decision to resign from the board," Mr. Palepu said. He said that he fulfilled his responsibilities fully and appropriately.

The two other independent directors who attended the meeting were T.R. Prasad, a former Indian cabinet secretary, and V.S. Raju, who is the former director of the Indian Institute of Technology at Delhi. Neither could be reached for comment.

The government sacked the directors who remained on Satyam's board as of last week and installed three new board members Sunday. On Thursday, it named three additional members: Tarun Das, an adviser to the Confederation of Indian Industry; T.N. Maharan, former pres-

Satyam scandal – The investigation

On January 25, 2009 Indian police arrested two employees from the affiliate of PricewaterhouseCoopers who audited Satyam Computer Services, the IT outsourcing giant at the center of the nation's largest fraud inquiry.

The move comes after Satyam founder Ramalinga Raju said he had fabricated $1 billion of assets and confessed to making up more than 10,000 employees to siphon money from the software company.

The Institute of Chartered Accountants of India (ICAI)

ICAI may give more time to PWC to explain Satyam fraud

Noida/ Hyderabad, Feb 2

The Institute of Chartered Accountants of India (ICAI) could give more time to tainted Satyam Computer's auditor Price Waterhouse which has yet not given an explanation to the showcause notice by the institute regarding the IT firm's accounting scam.

"Since the accountable persons are not in a position to reply to our questions, a request has been received (by ICAI from PW) to provide extended time," Institute of Chartered Accountants of India president Ved Jain told reporters here. "We should consider this...principle of natural justice demands that persons should be given a reasonable opportunity of being represented, of being heard. The time should be given."

PTI

Source: ***Financial Express - Mumbai*** **– February 3, 2009 - Posted on ICAI website**

Satyam scandal – The impact

The London-based World Council on Corporate Governance revoked the "Golden Peacock Global Award for Corporate Governance" it awarded the company in September 2008.

The India Stock Exchange took Satyam out of its Nifty Fifty stock index.

As of March 20, 2009, there is no word on whether Ernst & Young will withdraw its 2007 "Entrepreneur of the Year" Award from Ramalinga Raju, Satyam's founder and chief executive.

The Indian affiliate of PricewaterhouseCoopers was the company's auditor. It appears to have cCertified the company had $1.1 billion in cash when the real number was $78 million.

The FIFA (Soccer) World Cups in South Africa in 2010 and 2014 in Brazil may need a new "official IT services provider," assuming Satyam is not able to fulfill its obligations.

Satyam was the first Indian company to list on Nasdaq, but it later moved its listing to the New York Stock Exchange, which now has suspended trading indefinitely.

The World Bank said it would no longer do business with the company because Satyam had stolen data and bribed bank officials.

Source: Price Waterhouse Auditors Arrested in Satyam Inquiry, Saturday, January 24, 2009 www.bloomberg.com

Satyam scandal – The impact

Asian debacles highlight need for reform and greater scrutiny

"The Satyam affair has assured that every company in India is going to have to fight harder to attract capital."

Source: ***Financial Times*****, Friday, January 16, 2009**

Satyam scandal – Sale to an investor

‘Satyam Computer Services rose by 20% daily limit on the news that it has received approval from India’s capital markets regulator to offer a 51% stake to an investor.’

Source: Satyam Bidding Begins, *Wall Street Journal Europe,* Monday, March 9, 2009

Satyam scandal – Sale to a strategic investor

‘Indian IT major, Satyam Computer Services Ltd has hoped to finalize its buyer by April 30 for its 51 percent stake in the company. After months of being under the scanner for the fraud case, the biggest scam in Indian corporate history, Satyam Computers have finally found some bidders.

The potential bidders as for now are Larsen & Turbo, Tech Mahindra and Spice Group. The takeover transaction has many terms and conditions.

- **The buyer’s shareholdings <u>would have a lock in period of 3 years</u>.**
- **The buyer will also <u>not be allowed to sell any assets of the company for the next two years without the approval of the shareholders.</u>**
- **The buyer also has to retain the 100 key staffs for next one year, and cannot stop from continuing the main business of the outsourcer.**

Cooperation with the investigative agencies for investigating the fraud case and cooperation with the regulators is another agreement.

Satyam’s spokesperson said that those bidders who had submitted their detailed report of interest by March 20 will hear from them soon. The shortlisted potential bidders will be invited for the bidding. ’

Source: Satyam says plans to finalise buyer by April 30, Tuesday, March 24, 2009 http://in.news.yahoo.com/

Satyam scandal

Questions:

Compare the outcome thus far with the Skandia case.

Any comments?

Any comments on fraud