

The Satyam scandal: who is to blame and how can we prevent such in future?

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There are a few axioms that we work with – we believe there is a certain level of integrity in those we do business with, and that fraud is the exception, not the rule. Without a fundamental level of trust, it becomes difficult to transact business. The Satyam incident corrodes the individual's faith in the system. The casual observer is left wondering what other skeletons are going to tumble out of which other companies' closets. Obviously this is going to have an effect on India Inc. as a whole, and this could not have come at a worse time, given the global jitters.

It is surely going to be more difficult for other Indian IT service players to win business now, given that they will be tarred by the same brush. Competitors from other low-cost locations such as China, the Philippines, Vietnam, and Eastern Europe will certainly take advantage of the situation. This is something the IT services industry, facing as it is the threat of a serious reduction in business as fallout from the general market malaise, did not need.

Undoubtedly, this is going to hurt the prospects of foreign money flowing into India in the near future as well; and it was anyway looking a little shaky in the aftermath of the Mumbai invasion and the prospect of war with Pakistan. This will help extend the liquidity crunch and will depress the stock market. After all, India, running a substantial current account deficit, has been using inflows to help fuel its rapid growth. At a time when the incoming US President is warning of trillion-dollar deficits, India is likely to suffer from a cash crunch. Thus the overall growth prospects of the country may also be affected. Thus, it is a disaster for the country any number of fronts.

So who should take the ultimate blame, other than the Raju brothers? The SEBI, for lax oversight? The auditors, whose job it is to figure out any dubious things in the books? Isn't the then-finance minister ultimately responsible, the Harvard-trained P Chidambaram? Or the commerce minister, Kamal Nath? How about Oxford-trained Manmohan Singh? It was on their watch that this large crime was committed. If people take their responsibilities seriously, the Prime Minister and the former Finance Minister should resign in shame.

There may be a political angle to the Satyam scandal. Professor Vaidyanathan of IIM Bangalore has raised the possibility that there is a nexus between election-bound politicians and Satyam ("Impending polls may have pushed Satyam off cliff", DNA, Jan 10, 2009). There are also allegations about gigantic transfers of wealth to private hands, for instance in the under-pricing of the wireless spectrum. Surely, the politicians who enabled the skimming off of public wealth would have gained something in the process, too? There is something worrying in the quality of India's democracy if it sustains – and in fact needs – such fraudulent behavior.

People have been quick to compare the Satyam incident to the Enron affair and to the Bernie Madoff Ponzi scheme. This raises some serious questions: what causes this kind of behavior? What can be done to detect and prevent it?

Why do people get into fraudulent behavior? Perhaps it just became a habit. There was a statement in the Satyam letter to the SEBI – it talks about “riding the tiger, not knowing how to get off without being eaten”. Apparently once the books began to be falsified, the promoters embarked down a slippery slope. I suspect that in the intensely competitive IT services market, Satyam as the smallest of the big four IT players was under pressure to show extraordinary results in order to survive.

What is the solution to problems like this? It is probably not more intrusive government regulation. Despite the noises being made in America blaming all finance-sector problems on a lax regulatory environment, it is not clear that more paperwork is the answer. Consider Sarbanes-Oxley, which did nothing to prevent the current scams in the US. Nor did it prevent Satyam – because of the listing of its ADRs in the US, subject to SoX provisions – from doing what it did.

More regulation, especially in bureaucrat-heaven India, will probably just choke businesses to death, as in the dreaded days of red tape and the erstwhile, suffocating, License Raj – which, incidentally, did enrich those that had the right contacts.

One answer may well be technology. There are applications that can recognize known patterns that indicate fraud. Some may include data mining to identify new patterns of fraudulent behavior. But then machines can only go so far, and there is the danger of false positives. Therefore, human intervention will be required. The accounting profession has instituted Governance, Regulatory and Compliance practices. A combination of technology and human oversight that closes process loopholes may provide some relief. These might have, for instance, caught the \$7 billion Societe Generale fraud of last year.

In addition to punishing the guilty – all the guilty – we need to ensure this sort of scam does not happen again.

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