

## What the Satyam Debacle Means for the Indian IT Industry

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The Satyam accounting scandal represents another shock to an IT industry still reeling from the economic recession. However, Gartner predicts that “India Inc.” will remain a leading destination for offshore IT services.

## NEWS ANALYSIS

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### Event

On 7 January 2009, in a letter to the Bombay Stock Exchange, where Satyam Computer Services is publicly listed, the company's chairman Ramalinga Raju resigned from its board and claimed that "for a number of years," Satyam has been systematically and deliberately overstating its revenue and profits. Raju's letter also claimed he was personally responsible for these overstatements.

### Analysis

News about Satyam has shaken not only the Indian IT sector, but also the entirety of Indian industry, government and regulatory agencies. Nevertheless, Gartner views the Satyam incident as a singular instance of apparent corporate governance malfeasance within the Indian offshore industry, which is not indicative of the status of other viable, stable companies. We believe the Satyam scandal is unlikely to have a long-term adverse financial impact on the Indian IT industry in general.

Drawing parallels between the Satyam and Enron scandals has become common in press reports on Satyam. But the two incidents differ significantly in that, though we believe the Satyam brand name will not be able to recover, the underlying value offered by the company's assets — including 53,000 staff members, 28 development centers worldwide and solid methodologies and tools to deliver IT services — is still in place. In addition, the Satyam scandal is likely to have a limited financial impact within a local Indian IT industry that we estimate generates about \$60 billion annually.

Despite the publicity surrounding the Satyam scandal, the fundamental strengths of the Indian offshore model remains unchanged. India offers a combination of strengths and capabilities, coupled with the cost advantages and a quality value proposition. Enterprises have come to rely on this model and are likely to continue to leverage it. Further, the unique combination of factors that came into play in the Satyam case rarely occurs among other large Indian service providers. Despite having an extensive management team in each practice area and being a publicly listed company, Satyam was widely perceived as behaving like a family-owned, family-run company. Although investigations are still ongoing, from preliminary accounts it appears that the Raju family had a strong holding in two infrastructure companies, and that Ramalinga Raju may have exercised nearly independent leadership of Satyam.

In the short term, Gartner expects increased scrutiny of Indian service providers' governance and financial status. Current and prospective customers, other service providers, investors and government and regulatory groups should exercise strong due diligence to ensure that other scandals are not lurking. An assessment of management and governance structures is critical to the due diligence process to ensure appropriate appointments, exemplary segregation of duties and compatible authority and responsibility assignments. The Indian offshore industry should also be proactive in building transparency into its businesses. The National Association of Software and Service Companies (NASSCOM) should take this opportunity to lead an effort at self-policing by its member organizations.

## RECOMMENDATIONS

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### Customers of other Indian service providers

- Become more familiar with the organizational structure and governance of your providers, but continue your engagements with them, as the factors contributing to Satyam's difficulties are likely to prove unique.
- As a risk mitigation measure, consider asking for a certification of compliance to generally accepted accounting principles (GAAP) or their equivalent, certified by the CFO, CEO and the board of directors, and countersigned by the external auditors.
- If you are also a Satyam customer, as a contingency measure, consider assessing the ability of your other providers to take over projects currently run by Satyam, if necessary.

#### **Offshore service providers worldwide:**

- If you are an offshore, "nearshore" or onshore service provider, emphasize transparency as a best practice. Publicly offer details about your governance structure, financial management and internal controls.
- Ensure that your internal controls and enterprise risk management are in order. Consider retaining one of the top third-party auditors in the industry (rather than your regular auditor) to complete a full financial and internal controls audit. Make the audit results available to current customers and prospects.
- Arm your front-end staff (your sales and account management teams) with a strong corporate message to deliver to your customers and prospects. Any confusion or lack of clarity in this first line of contact could potentially raise red flags.

#### **RECOMMENDED READING**

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- "Prepare for Aftereffects of Satyam Accounting Scandal" — Until Satyam's position is clarified, its customers should create scenario plans to mitigate potential service disruptions. **By Frances Karamouzis and Partha Iyengar**
- "Satyam Issues Degrade Client and Industry Confidence" — Gartner analyzes the effects Satyam's difficulties may have on the broader IT industry. **By Frances Karamouzis**

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