

Prepare for Aftereffects of Satyam Accounting Scandal

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The chairman of Satyam has resigned after saying he falsified key financial results. Until the company's position is clarified, Satyam customers should create scenario plans to mitigate potential service disruptions.

NEWS ANALYSIS

Event

On 7 January 2009, Satyam Computer Services Chairman Ramalinga Raju wrote an open letter of resignation to the Satyam board and the Indian Stock Exchange regulators that stated Satyam's books have reflected deliberate overstating of its revenue and profits "for a number of years." In his letter, Raju claimed that he had:

- Inflated the amount of cash on the balance sheet by nearly \$1 billion.
- Incurred a liability of \$253 million on funds arranged by him personally.
- Overstated Satyam's September 2008 quarterly revenues by 28%.
- Overstated earnings before interest, taxes, depreciation and amortization (EBITDA) for 2Q08 by \$125 million.

As of 8 January 2009, these claims were still being investigated.

Analysis

Gartner has often stated that IT services are unlike hardware or software in that they focus on a relationship with a "trusted partner," rather than on a product. We believe Satyam's difficulties have considerably diminished its ability to retain and inspire this trust.

- In the current economic environment, enterprises consider financial indiscretions by any business intolerable; we believe this will severely handicap Satyam when prospective customers are evaluating potential partners.
- Satyam's financial position remains unclear, but based on the initial figures cited by Raju, Gartner believes Satyam will not be in a position to invest in client engagements, staff development or R&D — all critical elements for an IT services company. Satyam must also expend significant time and resources to work through its accounting issues and will likely face extensive external regulatory investigations both in India and in the U.S., where it is listed through an American Depository Receipt (ADR).
- Satyam will likely suffer from elevated attrition levels among staff and management, which could potentially affect the company's ability to deliver on projects.
- We believe that management will also be distracted by dealing with the company's internal issues, diminishing its ability to focus on external market issues and clients.

The single most important task Satyam faces is ensuring stable delivery of services to current customers. This will require extensive direct work with clients and also with the staff and operational management personnel leading its engagements. Satyam's main challenge will be to restore confidence in the company and its credibility among its customers and investors. Despite Satyam's reputation and past success, its recovery from recent events will depend on how much time, effort and resources it invests in developing and following an effective turnaround strategy.

RECOMMENDATIONS

Satyam customers:

- Closely monitor ongoing engagements and prepare contingency measures for potential service disruptions in the short to medium term while Satyam's position is clarified and potential management changes or staff turnover ensue.
- Evaluate offering "retention bonuses" directly to some key Satyam staff on your critical projects.
- Create a scenario plan with key action steps. Scenarios include staff or management disruption, shorter-term contract renegotiation, potential switching costs and vendor options, exit-clause terms, and long-term engagement and vendor viability.

Satyam competitors:

- Use the uncertainty about Satyam's future to potentially win more business.
- Be prepared to respond to increased scrutiny of your own financials and business practices.

RECOMMENDED READING

- "Q&A Regarding Best Practices for Selecting Service Providers" — Gartner addresses frequently asked questions regarding the selection of providers and provides advice on applying best practices. **By Fran Karamouzis and Richard Ni**
- "Market Overview: IT Services Providers in India" — Gartner categorizes India-based service providers by market share in different service lines. **By Freddie Ng and Arup Roy**

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