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"UNDERSTANDING CORPORATE GOVERNANCE: SUCCESS & FAILURE IN THE LIGHT OF TWO WORLD FAMOUS SCANDALS-ENRON & SATYAM: A PARALLEL STUDY"

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ABSTRACT

Some years ago corporate social responsibility was not an emphasized business practice in general. But it has gained a special emphasis in the last 10-20 years and corporate social responsibility is now seen as a driver of good corporate governance & the reasons behind was the need of a mechanism that ensures good corporate governance & a need on the part of corporate entities to fulfill their social responsibility that is taking care of the sector for which it has its existence. Various scandals in the recent years including Enron, Satyam, Tyco, Normura, Worldcom, Quest etc has further strengthened the need for a strong and effective mechanism for good corporate governance and other related aspects such as ethical practices of business and their responsibility towards the society. The paper gives an insight of various ethical concerns with respect to governance and social responsibilities of corporate entities & also suggests guidelines for ethical behavior. A parallel study of two outrageous corporate scandals has been provided herein so as to derive some lessons out of these two scandals & to suggest corrective policy actions/measures.

KEYWORDS: Corporate Governance, Corporate Social Responsibility, Business Ethics, Satyam, Enron

I. INTRODUCTION

The discussions over what constitute a good corporate governance & to develop a unified meaning of CSR has been continuing since a decade or so but with passage of time the terms have become more diversified and fragmented. The reasons are many ranging from a wide array of macro factors to various micro factors i. e. the factors that operate within a specific country only and vary from one region to another within a country. Many scholars, researchers, academicians have defined the terms in their own way but to some up Corporate Governance is the managerial practice of directing and leading a corporate whereas CSR constitutes all the actions of the management of the corporate that ensures sustainability & survival of the firm in long run. But now it has become all the more very important to understand the terms in their essence, the collapse of many large US Organizations such as Enron and the most recent collapse of Satyam (India) provides sufficient support for the argument.

The terms are not to be studied in isolation. Both the terms are interrelated since an organization that appears to be socially responsible is more likely to have a good corporate governance model. So the way in which organizations are governed may or may not be socially responsible but if it is socially responsible than undoubtedly it is because a model of good governance is being followed and thus CSR serves as one of those drivers that lead to good corporate governance.

At times corporate governance & good corporate governance are used simultaneously but one has to understand the difference between the two terms. CG refers to the way corporate are directed and lead whereas good CG refers to the ethical, socially responsible way of doing the same. So a Good Corporate governance model will ensure that the expectations of all the stakeholders are taken into account and not only of shareholders. The present paper is an attempt to understand these terms more comprehensively in the light of Enron and Satyam debacle. To achieve the objectives of the study the paper has been divided into VII Sections. Section I that is the present section gives an insight of CG & CSR, their interrelationship; Section II gives brief review of literature, followed by section III specifying objectives, relevance of study & methodology employed followed by section IV which is about analysis of case, section V suggests various flaws & the corresponding corrective measures, conclusion is covered in section VI followed by the last section containing references.

II. LITERATURE OVERVIEW

Bhasin M (2013) maintained that corporate entities irrespective of their sizes across the world are prone to accounting scandals and frauds. Just because of these frauds the credibility of the financial information gets reduced & therefore the decision making process by the investors also gets affected.

Cohen L, Frazzini A, Malloy C J (2012) assessed that the firms appoint independent directors who are sympathetic to management, but technically they are independent according to the legal definitions. Their study throws light on characteristics of independent directors and the firms who appoint them.

Kunal K (2011) concluded the advent of globalization has given birth to various giant big multinational companies with huge capital share and great management; therefore it becomes essential for the companies to follow some business ethics and moral to avoid the corporate fraud like Satyam scam. Corporate Ethics is very essential for good corporate governance. The need of time of is to review the structure of corporate governance in India and take a lesson from the past.

Shirur S (2011) concluded that Enron sank due to the agency problem while on the other hand Satyam was brought to its demise majorly due to tunneling. Usually, tunneling may not lead to sickness of the company (unless it is a case of vanishing company) and in the case of agency cost, many remedial measures have been suggested to align the interest of managers with that of the shareholders.

Khedekar D (2010) assessed that, in both the scams whether it be a Satyam or Enron the ability to swindle the investors was created due to the failure of the regulators and auditors. These ‘gatekeepers’ are the ones who the investor traditionally depends on to get information on how the company is doing.

Shivanna M (2010) concluded that there are series of provisions of companies act 1956 which can be used to punish and penalize the poorly performing directors and executives. The provisions are available and if properly implemented will lead to a good corporate governance. (nahi hai iske bhi-pdf paper likha hai)

Fernando A.C. (2010) maintained that corporate scandals & frauds committed against investors have been a regular and almost an annual feature in India. But the impact of Satyam scandal had created bad impact on corporate’s image in the corporate history of India.

Khan M.M.S and Sethi N (2009) concluded that ethically and socially responsible management can practice and implement good governance in the organization and Business schools as supplier of business managers can produce well trained and ethically responsible managers, who ensure best practices of corporate governance in their organization.

Banerjee A, Gokarn S, Pattanayak M & Sinha S. K assessed that the more significant the presence of investors who value good governance, the more likely it is that good governance practices will spread across the broader community of investors.

III. OBJECTIVES

The objective of our research paper is to analyze the potential & actual flaws within the system of governance of corporate entities and to identify the main reasons behind scams like Enron & Satyam. The paper also attempts to explain various corrective actions & lessons learned from such scams.

METHODOLOGY

The research study is based on the information collected from various secondary sources. Articles published in leading journals, websites, newspapers, company documents available online, various books & personal interaction with corporate professionals.

RELEVANCE OF THE STUDY

The study has importance in present time because the failure of Satyam was first of its kind that not only shook the investors but government also. Though, Enron, as far as is concerned was not the first of its kind in US but it was one of the giant collapses ever seen in US corporate world. The two scandals brought out various corporate governance failures & flaws that waited for their turn to get redressed. So the study is an attempt to hear their plea & make some suggestions.

IV. CASE ANALYSIS

A brief Historical background

Satyam

Beginning as a disparate group of companies SATYAM Group came into existence back in the year 1982 in Hyderabad when the group initiated two companies in the area of spinning & weaving and construction (1984). The business line was further expanded to shoe business, aquaculture & IT. By the year 1987 Satyam shed most of its unrelated business areas except the Constructions (afterwards named as Maytas) & IT business. 24^{th} June 1987 was the date Satyam Computer Services Ltd (SCSL) came into being, got the status of a public ltd company in the year 1991. In 2000 Mr. B. Raju was honored with IT man of the year award by Dataquest The company kept on writing its success story & in the same lead was awarded 3^{rd} rank for its corporate governance by Global institutional investors in 2005. In September 2008 it won the Golden Peacock Award for achieving excellence in its corporate governance practices by world council (London).

Enron

The company began its journey as a natural gas company named Northern Natural Gas Company in 1932 in Omaha, Nebraska and went through reorganization in the year 1979 as the main subsidiary of InterNorth. Enron Corporation finally emerged in 1985 to create the first natural gas pipeline system that was spread across the nation. In 1993 came the first international success for the company when Enron's Teesside power plant in England began operation. The company branched into many non-energy-related fields over the next several years, including areas such as Internet bandwidth, risk management, and weather derivatives. Although their core business remained in the transmission and distribution of power, their phenomenal growth was occurring through their other interests.[1]

[1] http://money.howstuffworks.com/cooking-books7.htm

The company was consecutively named as the "America's most innovative company" by fortune for 6 years.

What Went Wrong with the Two Companies that Ultimately Led to Their Demise?

Satyam-The Story of Lies

December 16, 2008: Unwarranted acquisition of two Maytas companies i.e. Maytas Properties and Maytas Infra against the proposed deal involving 1.6 billion $ but the intention got a thumbs down and share prices fell by 55%.

December 18, 2008: Jose Abraham blew the whistle in an email to one of the independent directors.

December 23, 2008: The announcement by World Bank that Satyam has been barred from business with World Bank for a period of 8 years led to 13.6% fall in share prices (Lowest in last 4 years).

December 26, 2008: The independent directors since 1991 Manglam Srinivasan announced his resignation.

December 28, 2008: This was followed by the resignation of 3 other independent directors viz Vinod K Dham, M. Rammohan Rao & Krishna Palepu.

January 7, 2009: The 7800 crore rupees scandal was announced and B. Ramalinga Raju gave his resignation.

January 09, 2009: Raju his brother and the auditors were arrested and sent to jail

June 21, 2009: Satyam was acquired and renamed as Mahindra Satyam and the executive board was also replaced. Vineet Nayyar was appointed as the vice chairman and afterward as chairman.

Enron-No More on

August 14, 2001: Jeffrey Skilling was replaced by Kenneth Lay as CEO.

Mid- to Late August: Sherron Watkins blew the whistle in an anonymous letter to Kenneth Lay expressing and afterwards discussed her concerns with a former colleague and audit partner at Andersen Mr. James Hecker.

October 12, 2001: The Company's documents were prompted to be shredded on an advice by an Arthur Andersen lawyer.

October 16, 2001: A quarterly earnings of $393 million was announced along with nonrecurring charges of $1.01 billion after tax to reflect asset write-downs primarily for water and broadband businesses.

October 22, 2001: Inquiries were initiated by The Securities and Exchange Commission

November 8, 2001: Financial statements were restated to incorporate partnership arrangements retroactively and as a result of this there was a sharp decline in earnings by $ 591 million (from 1997 to 2000), and debt for the year 2000 increased by $658 million.

November 9, 2001: Merger agreement with Dynegy was entered into.

November 28, 2001: Enron's debt securities were downgraded as junk bonds by Major credit rating agencies making the firm liable to retire $4 billion of its $13 billion debt. Dynegy also stepped out of the proposed merger.

December 2, 2001–Enron led for bankruptcy in New York and simultaneously sued Dynegy for breach of contract.

Key People/Parties to Fraud

Satyam

B. Ramalinga Raju (Founder member & Chairman who resigned from the board he realized the scandal could not be kept secret anymore)

B. Rama Raju (One of the promoter directors & brother of B. Ramalinga Raju, arrested along with him by CID Andhra Pradesh Police)

S Gopalkrishnan & S Talluri (senior partners-Price Waterhouse Coopers, arrested & booked by the CID Andhra Pradesh on charges of criminal conspiracy & fraud).

Manglam Sinivasan (Lone independent director since 1991 was the first to resign on December 25 for not casting a dissenting vote in the Maytas deal).

Vinod K Dham (Independent director & father of Pentium, appeared before the special court for Economic Offences).

M Rammohan Rao (Independent director & chairmen of the meeting in which Maytas deal was finalized).

Krishna Palepu (Independent director whose role also came under scrutiny on approving the Maytas deal).

Jose Abraham (ex-senior executive & whistle blower)

Enron[2]

Andrew Fastow: Former chief financial officer, sacked as the scandal unfolded, and alleged author of the deceptive accounting practices.

Kenneth Lay: Enron's former chief executive and chairman since 1986 refused to testify at the last moment after saying he had been pre-judged.

David Duncan: Enron's chief auditor at Andersen who shredded key documents relating to the case. It was his job to check Enron's accounts.

Joseph Berardino: Andersen's chief executive vigorously defended his firm's role in the affair.

Jeffrey Skilling: Enron's chief executive in the first half of 2001 denied knowing that anything was wrong at the firm

Sherron Watkins: Enron employee and "whistleblower" of the scandal. She claimed that Ken Lay was 'duped' and placed the blame on Jeffrey Skilling and Andrew Fastow.

V. VARIOUS FLAWS & CORRECTIVE ACTIONS

We have attempted to examine some of the common governance flaws in both the scandals-Satyam as well Enron. The following table enlists those common flaws with the corrective action that can prevent such miss happening in future.

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[2] http://news.bbc.co.uk/2/hi/business/1780075.stm

Table 1

Common Flaws in the System of Corporate Governance of Satyam & Enron	Corrective Actions/Suggestions to Prevent or Tackle Such Flaws
Audit Flaws-in both the cases the major culprits were the respective auditors- PwC(Satyam) & Arthur Anderson(Enron)	In order to fix the role of auditors there can be made stronger rule to control & define auditors' area of responsibility. The concept of joint audit can also be suggested as a compulsion. Also there should be independent regulatory bodies to monitor the auditors (PCAOB is already there playing such rolein US).
Board Flaws-whatever the auditors undertook were with the connivance of the directors of the company.	There has to be a check on the board of directors as to what they do, when they do & why they do it. They undoubtedly are answerable to the investors but they should be selected out of a rigorous process & should not be handpicked by promoter directors especially in case of independent directors. Also independent directors who are overly sympathetic to management, while still technically independent according to regulatory definitions.[3]
Rating Flaws-Enron was given sound ratings by various credit rating agencies even when it was at the verge of collapse. Similarly in case of Satyam too credit rating agencies blindly relied on the fraudulently prepared statements of the company.	There should be a proper mechanism to keep an eye over the credit rating agencies. These companies should be made more accountable. Moreover they should be asked to clearly disclose their rating methodology & the necessary documentary evidence so as to support the given rating. There should be stricter laws also to punish these companies if their ratings are found influenced or manipulated. Also these companies should be barred from providing allied services to their clients because it is likely to affect their independence.
Ethical Flaws-the major reason of downfall of both the companies were the unethical business conduct & the motive was to gain as was possible at the cost of investors.	In order to make sure that the companies work on ethical premise various committees ranging from audit committee to corporate governance & ethics committee can be formed. Companies can also have an Ethics & Compliance offices t make sure that the company functions as per the stated rules & laws.
Whistle Flaws (Whistle blowers-blown out) - in case of Satyam Mr. Jose Abraham played the role of whistle blower while the similar role was played by Sherron Watkins. No action was taken by the companies when the whistle blowers first blew the whistle internally.	Whistle blowers often do not come forward because of various fears. Companies can provide for a well established mechanism of whistle blowing so that employees of the company can report about the unethical business conduct, actual or suspected fraudulent practices etc.
Trading Flaws (Insider trading) - no doubt that the rampant scandals involved insider trading. In case of Satyam Promoters indulged into insider trading to create huge bank balances & cheated on investors. Similar was the case with Enron where the directors/CEO was charged of insider trading.	There should be established an effective mechanism to check for the insider trading practices. The ownership models should be continuously peeped into as to check who owns what percentage of shares & when they sell it. At times (especially in India where there is no prescribed rule) promoters pledge their shares & by this they keep on diluting their holding & therefore the existence of any artificial profits do not hurt them.

[3] http://www.people.hbs.edu/lcohen/pdffiles/malcofrazIII.pdf

VI. CONCLUSIONS

On a concluding note we would only like to emphasize that making policies & implementing them are two different issues altogether. Scandals like Enron & Satyam only prove that there was a complete failure of implementation of various laws. Such huge scams were getting cooked for so long & nobody could trace them raises a question on the part of various bodies & regulatory authorities also. In order to make sure that good corporate governance prevails & Enrons & Stayams are not repeated government of the country need to assure that policies are not only framed but followed too. There should be really harsh penalties on the guilty parties. Some of the commonly identified flaws are given above along with their possible remedial actions but the above said points definitely do not represent the scenario in entirety & there is really a need to go beyond the domestic territories while making or implementing any policy for corporate entities since gone are the days when two corporate entities were not linked now they are globally linked and can easily hide or falsify various facts & crucial information. There should be continuous check on the governance of the companies also they can be asked to compulsorily come with corporate governance reports periodically stating the mechanism, system, policies, decision taken in order to govern & manage the entity.

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The Enron scandal was an accounting scandal involving Enron Corporation, an American energy company based in Houston, Texas. Upon being publicized in October 2001, the company declared bankruptcy and its accounting firm, Arthur Andersen â€“ then one of the five largest audit and accountancy partnerships in the world â€“ was effectively dissolved. In addition to being the largest bankruptcy reorganization in U.S. history at that time, Enron was cited as the biggest audit failure.:61. At least two U.S. law firms have filed class-action lawsuits against Satyam, but given the companyâ€™s precarious finances, it is unclear how much money investors will be able to recover. According to experts from Wharton and elsewhere, the Satyam debacle will have an enormous impact on Indiaâ€™s business scene over the coming months.Â In the next 48 hours, resignations streamed in from Satyamâ€™s non-executive director and Harvard professor ofÂ It is possible that during this slowdown period, more scandals will come to light.â€ (U.S. financier Madoff last month admitted to running a $50 billion Ponzi scheme to keep his hedge fund afloat.)Â Useem draws a parallel between what occurred at Satyam with the scandals at WorldCom and Tyco, rather than at Enron. Corporate Governance Failure in Parmalat Separation of ownership and control in a large stock corporation. would be of no particular consequence if the interests of owners and managers coincided.Â The media have termed parmalat, a particular Italian scandal, and have suggested that the situation was more likely to arise in a country like Italy than elsewhere (Mulligan & Munchau, 2003; Melis, 2005). Given the criticisms of Italian corporate governance in the literature, this is not surprising (Melings, 2005; La Porta et al., 1997).Â As in the case of Enron, the failure of Parmalat to establish careful checking and monitoring structures within the companyâ€™s governance framework laid it bare to the abuse of power and fraudulent activity. The Satyam scandal highlights the importance of securities laws and CG in emerging markets. Indeed, Satyam fraud spurred the government of India to tighten the CG norms to prevent recurrence of similar frauds in future. Thus, major financial reporting frauds need to be studied for lessons-learnedâ€˜ and strategies- to-followâ€˜ to reduce the incidents of such frauds in the future. The increasing rate of white- collar crimes -demands stiff penalties, exemplary punishments, and effective enforcement of law with the right spirit.Â With no fast code for corporate governance in India, the company futile to go after the industry benchmark best practices and as a consequence, distorted.