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Satyam investors in the lurch as fraudster Raju sits in jail

Shefali Anand, The Wall Street Journal | The Wall Street Journal | January 07, 2010 10:51AM

THIS week marks the one-year anniversary of India's largest corporate governance scandal in recent years - the fraud at Satyam Computer Services.

Last January, Satyam founder B Ramalinga Raju confessed to overstating his company's profits for several years and creating a fictitious cash balance of more than $US1 billion ($1.1bn).

Renewal: Tech Mahindra has bought a majority stake in Satyam, and stock in the renamed company, Mahindra Satyam, has doubled in value. *Source:* Bloomberg

Raju is now in jail but that's little comfort to Satyam shareholders, some of whom are sitting on losses of more than 80 per cent over the past three years, even as the broad stockmarket is up more than 30 per cent over this period.

Their plight highlights what little recourse Indian investors have when one of their investments turns out to be a fraudulent bust, even though the market continues to rake in money from Indians and foreigners alike.

Says Virendra Jain, director of Delhi-based non-profit Midas Touch Investors Association: "Today, if one is cheated in the securities market, there is no provision for seeking any compensation from the errant party."

Last year, Midas Touch approached the Supreme Court on behalf of 300,000 individual shareholders of Satyam to demand compensation of $US108bn from Satyam's promoters, who founded the company, as well as its independent directors and statutory auditors, if they were found to be negligent in their duties.

However, the court didn't admit the lawsuit and advised that it be withdrawn. The court gave no reason for this response. But for individual shareholders, that's pretty much the end of the road for now.

This outcome underscores the poor legal infrastructure for stock investors in emerging markets like India and China. While stocks in these countries have been soaring lately, the laws don't provide adequate remedies for investors to recover damages in case of fraud, and regulators aren't aggressive enough to pursue action on behalf of shareholders.

While stock investors expect to bear the risk of market moves and the risk of a business success or failure, they don't expect to have to deal with deception and fraud, such as in the case of Satyam.

"Had the market crashed and (the stock) didn't pick up, I would still not feel betrayed," says Shanti Kumar, 50, a Hyderabad-based former employee of Satyam, who invested a large part of her savings in Satyam stocks.

Today, Ms Kumar's investments are worth less than a fifth of what they were in late 2008, and she believes they may never go back to their peak values.

Indian regulators can take some cues from neighbours. In 2008, thousands of individuals in Hong Kong were facing massive losses when mini-bonds held by them, which were tied to Lehman Brothers, became worthless. Investors claimed these bonds had been sold to them by banks as safe investments. Eventually, Hong Kong regulators forced the banks concerned to pay investors 60 per cent to 70 per cent of their original investments, setting a precedent.

In India, ‘where is justice?’ questions Ms Kumar. "I don't see visible action to put a fear of god into the people who're contemplating" fraud, she adds.

Satyam has often been called India's Enron, in reference to the fraud at the US energy company in which executives conducted fictitious transactions to boost the company's finances.

While the two cases are not strictly comparable, mainly because Enron went bankrupt and Satyam stock is still trading, albeit at a fraction of its peak price, it's worth considering what became of Enron's shareholders. They sued the company's bankers, directors and some auditors and eventually received various settlements from the involved parties, to the tune of $US7.2bn. This came to around one third of investors' original investments.

Securities laws in the US give shareholders the right to sue and recover damages from company directors and any officials who have profited by conducting fraud. But no such provision exists in Indian laws, say lawyers at international law firm Nishith Desai Associates.

The maximum that can happen is the company official may be charged criminally and some penalty may be imposed by the Securities & Exchange Board of India.

Midas Touch Investors Association had even approached the National Consumer Disputes Redressal Commission, the highest consumer protection court authority in India, for compensation in the Satyam case. However, the commission refused to entertain the petition, saying that the Central Bureau of Investigation and Company Law Board were already aware of the Satyam fraud, says Mr Jain of Midas. That was that.

Last year, Tech Mahindra bought a majority stake in Satyam, and the stock of the renamed company, Mahindra Satyam, has since doubled to around 110 rupees ($2.61).

Where Mahindra Satyam’s stock goes from here is dependent on the company's performance from here on, which some find tough to analyse at the moment. That's because Mahindra Satyam was given some leeway by regulators to not file detailed financial disclosures, which are needed to make a detailed analysis, says Anantha Narayan, head of equity research at ICICI Securities. ICICI is not now covering the stock.

For individual investors, the Satyam debacle serves up a few key lessons. For one, pay attention to the actions of the founders and directors of the company whose stock you own. If they don't own a large portion of the company stock, or are actively selling, as Satyam's. Raju did in advance of his confession, it's a red flag.

Second, don't concentrate investments in any one company, especially if you are working at that company. Satyam employees learned that the hard way. They got a lot of company stock as part of their pay package and many bought additional stock with their retirement savings. This was a bad move, because they were already exposed to the company risk given that their income was also dependent on it.

Ms Kumar of Satyam, who has now become wary of individual stocks, plans to consider mutual funds rather than individual stocks for future investments. "I would probably think mutual funds are slightly safer bets," she says.

Indeed, mutuals are relatively safer, not because mutual fund managers are smarter -in fact, many of them also invested in Satyam - but because the impact of a loss should be ameliorated by gains in other stocks held by the fund.