Surviving the Satyam Crisis

How can clients of Satyam minimize the potential damage to their business from the recent fraud scandal?

By Peter Bendor-Samuel, CEO

The world is reacting to the recent massive US$1 billion fraud scandal of one of the leading IT outsourcing suppliers in India. As the company now fights for its life, its current situation and dim future threaten to harm organizations that have outsourced their work to Satyam.

Companies are contacting Everest for advice on how to handle the situation. Our assessment is that this is a dangerous and deteriorating situation requiring Satyam's clients' immediate and effective action in order to stop the crisis from causing significant disruption and damage to their businesses. Taking a wait-and-see approach will likely expose clients to even further risk.

The crisis originated in the widespread deep and systematic fraud of its top executives, and there is a strong possibility that others on the management team may also be implicated. The company's cash flow is rapidly deteriorating and, although the government could step in and provide cash to stabilize the company for the short term, it has not taken that step. There are huge morale issues and employees are looking to leave – taking their critical knowledge of clients' business operations with them and negatively impacting service delivery in the meantime. Clients are stopping projects, the financial situation will worsen due to stranded costs, and potentially there will be a dramatic increase in receivables. What will happen in terms of legal issues is as yet unclear. The newly appointed board will only provide direction to the firm over the next few months and not participate in the operations.

With liquidity issues, talent loss and poor employee morale, legal issues, the doubtful capability of remaining management for managing the crisis, client flight, lack of new business, and unforeseen expenses, there is no realistic chance for recovery. We do not believe that Satyam will have enough credibility to continue to operate as a stand-alone entity, nor do we believe that another company will acquire Satyam as a whole (and certainly not in the near term).

Warning: Time is of the essence

One thing is certain: outsourcing risks don't get higher than this situation, and time is of the essence in minimizing the potential damage. For Satyam clients, the risk of not maintaining their business continuity is now significantly high, and responding proactively must occur within days, not weeks.

Satyam's clients must act quickly and make decisions with significant repercussions, even while the situation is still rapidly evolving. Thus, these decisions will be based on an expectation of potentially needing to adjust the remediation approach on the fly.

Non-critical project work. We recommend that clients immediately evaluate their exposure to Satyam. For those with discretionary, or non-critical project-based work (e.g., systems development, research and development testing), we recommend that, where possible, they put the work on hold and look to transition the work to another supplier.

Critical business processes. Clients that have outsourced critical processes to Satyam need to not only re-source service delivery to a different supplier or move the operations back in-house but also must move quickly into crisis management. For critical processes that impact cash flow, customer-facing activities, regulatory/compliance activities, or information security, we recommend moving quickly into a crisis management framework that includes the following steps:

- Establish a crisis management team and mindset
- Secure access to all systems
- Secure intellectual property
- Gain control of all code, data and knowledge management tools
- Secure process and operational knowledge within delivery staff (acquiring existing Satyam staff may be a viable strategy)
- Don't slow down remedial action by putting out a request for proposal to find another supplier; immediately move the work to a different supplier's platform

Finding an alternative supplier for critical functions is an effective risk-mitigation strategy, even if it means paying twice for the services.

Crisis realities and perceptions

Reacting to news of the crisis this month, some companies may be considering scaling back their plans to outsource offshore or may specifically question the credibility of Indian outsourcing suppliers.

We caution that the Satyam situation is not a crisis of the offshore or the Indian delivery model; it is solely a crisis of poor governance within Satyam. It is an example of deep corruption in one company, and the world has seen plenty of examples of corporate fraud in many countries. As with Enron, its fraud scandal did not taint its entire industry, nor will the Satyam situation taint outsourcing or offshoring.

Three lessons learned. The Satyam crisis, does, however present three learnings around risk mitigation, which are important in the way forward for outsourcing buyers. These include:

1. **Multi-supplier strategy.** This situation points to the value of having multiple suppliers supporting a buyer's work. Moving applications from one supplier to another is much easier with an existing relationship than having to establish a new outsourcing relationship.

2. **Contractual "outs."** The current crisis re-focuses attention on the necessity of ensuring an outsourcing contract includes effective terms for handling the exit of a relationship in a crisis situation.

3. **Risk calculation.** It is highly unlikely that anyone would have picked up on Satyam's fraud situation until it hit the headlines. Since its occurrence, outsourcing buyers will now be wise to include such a situation among their outsourcing risk calculations.

Further analysis of the situation

Everest Research Institute has developed a comprehensive analysis of the game-changing Satyam crisis and decision data supporting clients' responses in dealing with this situation. The report includes issues surrounding the crisis and its implications for buyers and suppliers, pros and cons of four recommended options for Satyam clients in responding to the situation, risk assessment, and facts and analysis on supplier alternatives if transitioning away from Satyam.

For more information or to purchase the report, please contact Kathy Sadden at ksadden@everestgrp.com.

About Everest Group

Everest Group (www.everestgrp.com) is a global consulting firm that assists corporations in developing and implementing leading-edge sourcing strategies including captive, outsourced, and shared services approaches. Everest helps companies create strategies and sourcing relationships that deliver total value – improving performance and results while managing the risks in such initiatives.

Since 1991, we have completed 300+ engagements, advising clients on complex sourcing issues in more than 30 key business processes worldwide. Our experience spans numerous Fortune 1000 clients in banking, insurance, retail, healthcare, telecom, media & entertainment, and hospitality sectors, among others.

Our breadth and depth of experience enables us to deliver expert analysis and strategic results. Our flexible, collaborative approach analyzes the specifics of each sourcing challenge. Throughout the process, we encourage collaboration between buyers and service providers to spark creativity and lay the groundwork for long-term outsourcing success. The result is a solution that recognizes the strengths, weaknesses, and strategic objectives of both parties.

Everest Group is headquartered in Dallas, Texas and has offices in Toronto, New York, London, Amsterdam, New Delhi, Melbourne, and Sydney.

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