LIBERAL ECONOMICS AND MANIPULATIVE CORPORATE ACCOUNTING

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RESURGENCE OF LIBERAL ECONOMICS

THE last quarter-century (1977-2002) had witnessed a remarkable resurgence of freedom-oriented economics after having traversed for some half-a-century on State-oriented turf contemptuously termed by Friedrich A. Yon Hayek (1899-1998) as The Road to Serfdom (1944). In India, for three decades (1947-77) following the attainment of independence, the continuous rule of the Congress Party at the Centre witnessed the heydays of the nationalisation and also of the public sector. The mighty reaction against regimentation, heightened by the infamous imposition of national emergency (1975-77), was followed by a landslide victory of the Janata Party led by Morarji Desai as Prime Minister in March 1977. While Indira Gandhi's Congress Party recaptured power early in 1980, and nationalised a few more private banks, this Party itself underwent a miraculous transformation in course of time. In 1991, Prime Minister Narasimha Rao and Finance Minister Manmohan Singh manifested the Congress Party's V-turn toward Liberalisation, Privatisation and Globalisation (LPG). Atal Behari Vajpayee, the seasoned leader of Bharatiya Janata Party (BJP), also chose to follow liberal economics as Prime Minister, for a brief spell in 1996 (when he approved the revised deal of ENRON/DPC) and continuously from 1998 onward, though being opposed by the Congress Party from time to time, as also occasionally by some of his coalition/NDA partners.

This naturally delighted the capitalist lobby of the West. Clive Crook (1993), Deputy Editor of *The Economist*, went on record saying: "Some countries – India, for instance – had followed aspects of the Soviet model more faithfully and had tied their economies more intimately in trade to the communist countries. In such cases, the link between the events of 1989-91 and the adoption of more liberal economic policies was more direct. These connections make it all the more plausible to see in these transformations one larger thing: the triumph of capitalism (Clive Crook, 1993)." Yet, while dwelling upon "The future of capitalism", he posed the question "Will liberal economies be the victim of its own success?" Or, as the events of the last decade seem to suggest, the very supposition of success was more of a mirage than ground-reality.

It is pertinent to note that Samuelson and Nordhas (1989) had cautioned: "But we should not glorify past achievements. The advanced industrial economies have not attained economic *'nirvana'*. They cannot attain stable prices and full employment; poverty is on the rise; the international banking system is threatened by staggering debts of developing countries; American farmers are in bankruptcy courts in droves; tens of thousands of toxic waste sites plague landscape; unemployment in Europe is at its highest since the great depression (Samuelson and Nordhas, 1989)". But this advice was not headed to by the powers that be and the LPG doctrine was pushed forward.

Emerging Corporate Governance

The rules of corporate governance were first specified in the ancient India thousands of years ago as postulated in the *Rigveda*, the oldest book on record in the whole world. In that historic text, "*harmony*" was the watchword and "*symphony*" amongst all the stakeholders was the *modus operandi*. That is to say, "*Prosperity for all*" was

the common corporate goal. It was the economics of "plenty" and not of "scarcity" wherein private interests came into clash with public policy (Om Prakash, 2001).

Kautilya's *Arthasastra*, written well over two thousand years ago (some three hundred years before the beginning of the Christian calendar), presented more of operational details with regard to the corporate governance. The learned academician- cum-statesman prescribed, *inter alia*, "three" as the ideal size of a Corporate Board which (incidentally, if not consciously) found flavour with the US Government in 1933 for a giant Public Corporation like the Tennessee Valley Authority (TVA).And, on the basis of personal interviews with Board Members during the course of my visit to the TVA headquarters in the USA, I found that this small-sized long-tenure Board with staggered terms of office had proved to be a viable basis for high quality of corporate governance. It was pointed out by Mr. Don McBride, member of the TVA Board, that he remembered "not one occasion when three members have not been able to arrive at a unanimous informal decision (Om Prakash, 1971)."

John W.Gardner, President of the Carnegie Foundation, raised a very pungent question – "Can we be equal and excellent too?" – in his book on "Excellence" first published in 1961. Its revised edition, possibly motivated by the challenge emanating from the meteoric rise of some other nations after colossal wartime destruction (which America luckily escaped), noted a plethora of troublesome questions on its jacket: Can our society achieve and hold to standards that will enable us to survive in a toughly competitive world? Is excellence possible in a democracy? Can an egalitarian society tolerate winners?

A number of other books on similar themes appeared about this time, including the celebrated "*In Search of Excellence – Lessons from America's Best-Run Companies*" authored by Thomas J. Peters and Robert H. Waterman Jr. Unfortunately, many of such researches did not appear to be sufficiently sustainable since quite a few of the stars projected therein found themselves in dangerous straits within two decades. By contrast, the Eastern models depicted in bestsellers like William G. Ouchi's "*Theory Z – How American Business can meet the Japanese Challenge*" (1981) and "*The Art of Japanese Management – Applications for American Executives*" (1981) by Richard Tanner Pascale and Anthony G. Athos (consultants to numerous Fortune 500 companies) were, in general, able to keep themselves away from the chain of accounting aberrations recently witnessed in the Western headquarters of Big Business. After all, it was India's age-old export-quality culture which fructified in Japan, while not so effective in post-1947 India which, consciously or unconsciously, got fascinated by the mirage of multinational corporations (MNCs), mostly of American origin. The seven spiritual values guiding many of the multinational corporations (MNCs) of Japanese origin are (Om Prakash, 1994):

- National Service through Industry
- Fairness
- Harmony and Cooperation
- Struggle for Betterment
- Courtesy and Humility
- Adjustment and Assimilation
- Gratitude

Genesis of Manipulative Accounting

At the outset, it was the greed of CEOs (and other top bosses) of MNCs which, directly or indirectly, carried compensation packages to dizzy heights, often having little tangible relationship with the size of operations, shareholders' value, employee morale, customer satisfaction, public relations' image or even with commercial efficiency in a narrow technical sense. For the year 1999, Charles Wang, Chief Executive of Computer Associates INTL (a relatively small entity) claimed the highest total pay of over $655 million (salary and bonus less than five million, supplemented by a fat long-term compensation of over $650 million) amongst the American

corporations. It was seven times the total pay of some $93 million (salary and bonus $13 million, plus long-term compensation of $80 million) made available to the legendary Jack Welch of General Electric (fifth rank in USA arid ninth in the Global Fortune 500 list of the year 2000 based on 1999 revenues). Carleton Fiorina, CEO of Hewlett-Packard (of Excellence fame) drew the lowest salary and bonus of less than one million dollars ($654,000) for 1999 (amongst the first twenty top-paid Chief Executives of the American corporations), while the total pay aggregated to $69 million (roughly one-tenth of the highest paid). Michael Dell of USA's Dell Computer took $236 million, over 100 times of what Dhirubhai Ambani of India's Reliance (two million dollars) drew in 2000. Michael Eisner of the celebrated Walt Disney gave the least (0.2 per cent) to shareholders, while David Wetnereu of CMGI gave the most (3,964 per cent) in Corporate America.

Similar is the story of the net worth of individuals as revealed by Forbes' List of 400 Richest Americans (September 2002). Microsoft Chairman, William H. Gates, in spite of an erosion of $11 billion last year, topped the list with $43 billion still left. Microsoft's co-founder, Paul Gardner Allen, stood third with a net worth of $21 billion, while Microsoft President, Steven Anthony Ballmer, had about $12 billion to his credit at the tenth rank. By way of contrast, Warsen Edward Buffet (an investor of Berkshire Hathaway occupying the second rank) increased his fortunes from $33 billion to $36 billion despite economic recession and sharp drop in stock prices. Challenging the superiority of the New Economy, Walmart Stores rose to the top position amongst the Fortune's Global 500. The five heirs to the late Walton's Wal-Mart fortune claimed a net worth of $18.8 billion each bracketed at No.4 a total of $94 billion (The Economic Times, 2002). Azim Hashim Premji of Wipro happened to be the lone Indian to make the grade (at 49th place) in the Rich List of 50 published by Sunday Times (London) on April 7, 2002. His fortune stood at $4.5 billion (down from $4.8 billion in 2001).

Liberal economics has given a big boost to the merger mania. The honours list of (1998) was presented as follows with estimated valuation in billio\1 US dollars (The Economic Times, 1998):

Table 1: Selected Major Mergers (1998)

(i)	Exxon and Mobil	236
(ii)	Citicorp and Travelers	140
(iii)	British Petroleum and Amoco	54(A)
(iv)	Daimler-Benz and Chrysler	40.5
(v)	Amertech Corp and SBC Comm.	72.4 (P)
(vi)	Bell Atlantic and GTE Corp.	70.9 (P)
(vii)	AT & T and Telecom Inc.	70 (P)
(viii)	National Bank and Bank America	61.6
(ix)	American Home Products and Monsanto	39.1 (F)
(x)	World Com and MCI (1997)	43.4

Note: A = Announced; P == Proposed; F= Failed

It was a massive movement toward monopoly capitalism much to the detriment of competition which liberal economics was supposed to promote. The combined valuation of Exxon and Mobil (at that time) was of the order of India's national income. The transcontinental merger of Daimler-Benz (Germany in Europe) and Chrysler (USA in North America) was a major step toward global monpolisation of the automobile industry. The Big Three (General Motors, Daimler-Chrysler and Ford) in the Fortune 500 list of 1999 (based on 1998 revenues) said on February 25,2000, that they planned to funnel their combined $240 billion in annual spending on supplies through a single Internet portal, creating the world's largest virtual market. It was proposed to be extended to all their suppliers with a combined annual spending of $500 billion.

Some of the other M&A (mergers and acquisitions) deals are noted below (The Economic Times, 2002):

Table 2: Selected Major Deals (1999-2002)

Year	Company	Deal	Value (Billion US dollars)
1999	Vodafone	Purchase of Mannesmann	20
2000	AT&T Wireless	IPO	11
2000	GlaxoWellcome	Purchase of Smithkline Beecham	77
2000	Pepsi Co	To buy Quakeroats	80
2001	America Online	Purchase of Time Warner	181
2002	AT&T Broadband	Purchase of Comcast	72
2002	Pfizer	To buy Pharmacia	60
2002	Hewlett Packard (HP)	Purchase of Compaq	25
2002	Tyco International	Divestiture Plan	10
2002	Reliance Industries (RIL)	To take over Reliance Petroleum (RPM)	10

The merger of RLL and RPM was a fulfilment of the lifetime ambition of India's ace entrepreneur, Dhirubhai Ambani (December 28, 1932 - July 6, 2002), to enter the global list of Fortune 500 (as the first private sector company of Indian origin to make its debut). The Reliance Flagship Company, after merger, gets the third global rank in the number of shareholders (3.5 million), next to Metlife (8.5 million) and AT&T (4.8 million). The new RIL is head and shoulders above the next in the global list (AOL with 19.8 million shareholders holding the fourth rank). Not only that, America Online (AOL)'s acquisition of Time Warner looked like trying to chew much wore than what one could digest. It has been described in certain quarters as a reverse merger of the USA (somewhat like main ICICI merging into its associate – India's ICICI Bank). Consequent upon the colossal goodwill write-off, the Internet and media giant (AOL Time Warner) posted a record net loss of $54 billion for the first quarter of 2002. The purchase of Compaq by HP (adjudged as the excellent two decades back) almost caused an organisational earthquake culminating in the elimination of Walter-Hewlett from the Board of the Company, his father founded. Not only that, because of merger with Compaq, HP was to cut 1,500 jobs by November 2003, a year ahead of schedule.

In the LPG era, stock options and insider trading have provided a major motivational force to manipulative accounting and financial fabrications. The rationale behind the giant of options to CEOs and other top-echelons to buy and sell shares of their own undertaking was to create a sense of oneness between the interests of the Corporation and its stakeholders besides the saving in cash on compensation packages. But, this practice turned out to be a common tool in the hands of corporate leaders to make illegitimate profits on the basis of sensitive inside information available to them. They could buy shares after presenting a pessimistic outlook and declaring a low or nil dividend, resulting in a collapse of market sentiment. Then, they could offload those very shares after an optimistic reporting coupled with a high or unwarranted dividend declaration, leading to a bullish impact on the stock market. Such malpractices also abound when M&As or GDR/ ADR issues are under contemplation. In India, soon after the initiation of liberalised economic reforms in 1991, the aforesaid activities were sought to be controlled by the SEBI (Insider Trading) Regulations, 1992 and other such restraints from time to time. There was also India's major stock exchange scam of 1992, followed by a long chain of nerve-breaking oscillations, whether autonomous or imported from foreign financial centres like NASDAQ, but often out-of-tune with specific corporate performance as such. India's common investors are estimated to have lost $10 billion in Non-banking Finance-Companies (NBFCs) duriug 1991-2001.

Case Studies

Bankruptcies are an accepted ingredient of liberal economics, and the American capitalism in particular. But it was the most unexpected event when a giant like Enron Corporation filed the biggest-ever bankruptcy

petition in New York on December 2, 2001, after a spectacular upswing in consecutive Fortune 500 lists as presented below:

Table 3: Fortunes of Enron Corporation

Fortune 500 list for the year	(Based on Revenues of the year)	Rank (USA)	Rank (Global)	Revenues ($ Million)	Profits ($ Million)
1998	1997	59	179	20,273	105
1999	1998	28	85	31,260	703
2000	1999	19	62	40,112	893
2001	2000	7	16	100,789	979

Inter alia, the following factors participated the downfall of Enron:

(i) Behind this apparent prosperity was Enron's mounting long-term debt which had exploded from $3.3 billion (1996 Balance Sheet) to $6.3 billion (1997 Balance Sheet). Additionally, there were undisclosed loans, partly camouflaged as "Liability for Price Risk Management Activities" and "Others" aggregating $2.9 billion in the 1997 Balance Sheet. While these liabilities grew, "Assets for Price Management. Activities" shrank. Citigroup reportedly lent Enron $2.4 billion between 1999 and early 2001 to be paid in five years. There were other lenders also.

(ii) Some of the Enron officials made tonnes of money in stock exchange speculation while many employees lost much of their retirement accounts. Kenneth Lay, former Chairman, was reported to have sold, during 2001, $100 million in company stock including a large portion sold back to employees after an employee had warned him about an accounting debacle. A spokeswoman for Lay confirmed the sale (February 16, 2002) but pleaded that the transactions were motivated by a desire to pay off personal loans rather than a lack of confidence in Enron's future. The sales included $20 million of shares disposed of in the three weeks after Sherron S. Watkins, an Enron official, had warned Lay that energy trading giant was in danger of collapse in a wave of Accounting Standards. Ironically enough, employees were said to have been encouraged to invest in Enron stock without being notified of the company's precarious financial position.

(iii) There was the negative impact of a decade long internal rivalry between Jeff Skilling, the former Enron CEO projected as a visionary and Rebecca Mark, the high-profile lady who firmly held the fort of Indian operates while the Dabhol Power Company faced many vicissitudes during the 1990s (Om Prakash, 2002). The Enron founder, Kenneth Lay, had difficult options in deciding which way to go. Things turned tortuous and temptuous as some of the Enron officials had had high political connections transcending the White House and the financing of the US Presidential Election held in November 2000. However, President Bush who assumed charge thereafter talked of corporate ethics and proclaimed in mid-2002 that he would act tough to curb accounting frauds so that the errants would invite penalties. But, under the American dispensation, most crimes can get compounded in money terms not necessarily in tune with the quantum of misdeeds.

(iv) The cozy ties between Enron Corporation and Andersen's Accounting Firm meant facile movement on the road to disaster for both. As early as December 1999, a worried auditor at Anderson was asking hard questions about murky books and records relating to Enron. Certain incriminating documents were reportedly suppressed or mechanically destroyed, keeping the investors, other stakeholders, and even the management at various levels in a state of darkness. The Firm which used to recruit 2,000 students every year was abandoned by quite a few clients, so that many trainees got stranded in their accounting career. Andersen lost pharmaceutical giant, Merck & Co, a 30-year audit client. Indian operations of Andersen were acquired by Ernst and Young. According to a settlement dated March 1, 2002, Andersen agreed to pay $217 million in Arizonia Supreme Court over allegations of negligence by a trust for the Baptist Foundation of America (without admission of any wrong doing as such). At the level of US Securities and Exchange Commission (SEC), Harvey Pitt was criticised for inability to show leadership in tackling the glaring failings of Wall Street and corporate bosses.

At the top of this infamous accounting scandal, was the unhappy story of Worldcom which had taken over MCI in 1997. The revenue of MCI Worldcom in 1998 was of the order of $18 billion with a terrific loss of about three billion dollars which, except for some Japanese MNCs, was the highest on record in the entire Fortune 500 list of 1999 (based on 1998 revenues). However, by the year 2000, revenues of Worldcom had more than doubled to $39 billion with a handsome profit of over four billion dollars. Though lower in rank as compared to Enron, Worldcom was reported to have fallen prey to a bigger scandal involving about four billion dollars ($3.06 billion in 2001 and $797 million in the first quarter of 2002). Here also, audit was conducted by Anderson, who claimed that the company withheld key information and did not consult its auditors about the accounting treatment of its expenses. The SEC filed suit on June 26, 2002, in Manhattan federal court that Worldcom (No.2 US long-distance telecom operator) had concealed expenses to artificially inflate earnings for meeting Wall Street expectations. At the same time, its political donations were reported to be higher than those of Enron. Worldcom established another record of declaring bankruptcy on July 21, 2002.

So loud was the public outcry against big business, bolstered by liberal economics that some of the famous CEOs refunded or surrendered part of their retirement benefits which appeared to be unreasonable to the common eye. Percy Barnevik, after merger of Sweden's Asea and Switzerland's Brown Boveri, was CEO of ABB fame from 1988 to 1996 (and non-executive chairman up to November 2001). The leading light in management agreed to refund some 100 million Euros of "improper retirement payment."

Jack Welch, who retired in 2001 as GE chief after 21-year long innings, said on September 16, 2002, that he had given up free use of company planes and company apartments, for which he might be paying over two million dollars a year. At the other extreme, the czars of Corporate America, who cooked the books to fool investors, regulators and shareholders, earned 70 per cent more than the average payments to CEOs of large companies according to the Report "Executive Excess 2002: CEOs cook the books, skewer the rest of us" brought out by the Institute for Policy Studies and United for a Fair Economy (Silicon Valley). Between January 1, 2000 and July 21, 2002, the value of shares of 23 firms under investigation by the Justice Department SEC and other agencies for accounting irregularities, plunged by $530 billion (about 73-per cent of their total value). They have suffered 162,000 lay-offs since January 2001 CEO-worker pay gap of 42 : 1 in 1982 rose roughly ten times to 411:1 (The Times of India, 2002).

Resumé

The global resurgence of liberal economics during the last quarter-century (1977- 2002), and more particularly since 1991 when Indian polity made U-turn to launch economic reforms with a fanfare, manipulative corporate accounting has been the order of the day. Partly dictated by the myopic commercial compulsion of showing rising results quarter-by-quarter, it was, more generally, due to the ridiculous rise in executive compensation, particularly in Corporate America.

Many of the Japanese MNCs, in spite of heavier red-ink entries, preferred to abide by seven spiritual values typifying India's age-old export-quality culture. But, unfortunately, India's emerging corporate governance drew little from the rich heritage of the *Rigveda*, Kautilya's *Arthasastra* and other indigenous scriptures of wisdom and prudence. Corporate India was more impressed by Corporate America even though this mutual appreciation proved costly for both in terms of ethical erosion.

The continent of Europe would appear to have been more cautious in avoiding accounting scandals, so much so that Daimler-Chrysler cried from their house-tops in Germany regarding the veracity of their accounts. However, the British thinking continued to be typically capitalistic, even after the Labour Party (once an emblem of nationalisation and socialism) had secured two consecutive landslide victories in 1997 and 2001 respectively.

Arbitrary stock options, insider trading, frenized speculation and mergermania were responsible for piercing big holes into corporate morality and accounting ethics. In general, bigger fish (often foreign) have devoured smaller fries (often domestic), even if more efficient. Some reverse mergers, too, have turned tortuous.

An incisive study of "True World Income Distribution, 1988 and 1993", by Branko Milanovic of the World Bank (TheEconomic Journal, 2002) creates a question regarding the legitimacy of economic policies pursued by many countries under the umbrella of LPG (Liberalisation, Privatisation and Globalisation), namely 'Liberalisation

for whom, rich or poor?' In terms of this study, China and India were the largest between-countries contributors to inequality in 1993 with a total of 18.9 Gini Points (GPs) in juxtaposition to the United States, Japan, Germany, France and the United Kingdom. The United States enjoyed 29 per cent of world income with only 5.6 per cent of world population. The ratio between average income of world top five per cent and world bottom five per cent increased from 78:1 in 1988 to 114:1 in 1993.

The immediate agenda for curbing manipulative corporate accounting could be, *inter alia*, as follows:

(i) Mandatory rotation of (unconnected) Auditors after (every) three years;

(ii) Limits on executive compensation, not more than ten times the average employee pay;

(iii) Mandatory introduction of independent professional Directors not holding any shares of the company/ group concerned, at least one-third of the Board strength;

(iv) Prohibition of all dealings in shares of the company/group concerned on the part of directors and executives holding sensitive positions without prior approval of, and full disclosure of reasons before, the Board of Directors; and,

(v) Insistence on timely publication of medium-sized company reports which are neither too bulky to be ignored nor too sketchy to miss the hard-core reality.

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