Indian business & finance

Whistleblowers put India's Infosys business model on the spot

Outsourcing company hit by simmering discontent over succession and direction

Infosys's core success came from helping multinationals to manage their clunky IT systems © Reuters

Benjamin Parkin in Bangalore 8 HOURS AGO

As Infosys prepared to welcome analysts to its sprawling Bangalore base this month for the first time since being rocked by damaging whistleblower allegations, the embattled information technology company put on a defiant show of unity.

Chairman Nandan Nilekani didn't mince his words in publicly rebutting rumours that infighting had prompted disgruntled members of Infosys' original gang of co-founders, along with former employees, to orchestrate the accusations.

"These speculations are appalling," said Mr Nilekani, himself a co-founder, urging patience as an investigation by an external law firm ran its course. They "seem to be aimed at tarnishing the image of some of the most accomplished and respected individuals".

But in the five years since Infosys's old guard, led by legendary founder Narayana Murthy, first handed control to outside management, simmering tension over the succession and Infosys' subsequent business direction has spilled into public view multiple times.

This has taken a toll on the iconic company as it has sought new strategies to navigate an increasingly cut-throat global outsourcing industry, where Infosys and others have faced slower revenue growth and shrinking margins. "This is a clash of egos, and a clash of culture, which is at work," said one former employee. "I don't know where this will end."

The most recent round of anonymous complaints, when they were leaked to the media in October, prompted a one-day, 15 per cent sell-off in Infosys shares and an investigation by the

US Securities and Exchange Commission.

$250

Infosys's starting capital in 1981

Whistleblowers who claim to be current employees alleged that chief executive Salil Parekh and chief financial officer Nilanjan Roy — both recruited externally in 2018 — oversaw irregular accounting practices, misled the board and auditors and sought to misrepresent costs in order to show short-term financial gains.

The allegations come only two years after a separate round of complaints over alleged lapses in governance standards, this time coming from Mr Murthy himself, culminated in the resignation of Infosys' first external chief executive, Vishal Sikka. The company at the time lashed out at what it called Mr Murthy's "continuous assault".

Infosys said it has received no evidence to substantiate the most recent claims, but the investigation is ongoing. Mr Murthy and Mr Nilekani declined to comment, while Mr Parekh and Mr Roy could not be reached for comment. Mr Sikka didn't respond to an emailed request. The two executives denied the allegations to the company's board, according to channel CNBC-TV18.

"It's tragic," a person close to the company said. "This is a story of succession."

Exacerbating the tensions are sweeping changes in the global outsourcing industry, which Infosys has had to navigate. Clients have become more cost-conscious, nimble competitors started offering cheaper services and demand for automated or artificial intelligence-driven packages increased.

There's a new set of people. They've got different motivations, they've come from different backgrounds, they've got a different way of doing things

Amit Tandon, Institutional Investor Advisory Services

Revenues in the sector were growing around 40 per cent a year before the 2008 financial crisis, according to Credit Suisse, but have since slowed to around 10 per cent. Margins, meanwhile, have also trended lower over the past 15 years.

"It has become more bloody than it was 10 years back," said one analyst. "Everyone is fighting for deals. There's less meat on the table now, so you have to fight for it."

Started in 1981 by Mr Murthy and six co-founders with $250 in capital, Infosys grew to become one of India's largest companies with $12bn in revenues and over 200,000 employees.

The company's core success came helping multinationals such as Cisco and Pfizer to manage their clunky IT systems, and it sought to distinguish itself from existing Indian businesses by promoting high governance standards, transparency and "compassionate capitalism."

Its co-founders have since mostly moved on, with the exception of Mr Nilekani, who returned as chairman amid the upheaval of Mr Sikka's 2017 resignation. Some observers said that the handover to outsiders like Mr Parekh, who joined from rival Capgemini, would inevitably stir tension in a business founded on such lofty ideals.

"There's a new set of people," said Amit Tandon, founder of Institutional Investor Advisory Services. "They've got different motivations, they've come from different backgrounds, they've got a different way of doing things. Let's see if it works or not."

Whistleblowers allege that chief executive Salil Parekh oversaw irregular accounting practices © EPA

But some investors said they feared governance oversight at Infosys had suffered. Even if sceptical of many of the whistleblowers' accusations, they were unhappy that the allegations were leaked to the media rather than released by the company proactively, which had received the complaints several weeks earlier.

"There's a shock. How can these guys not tell us this?" said one. "I absolutely expected higher."

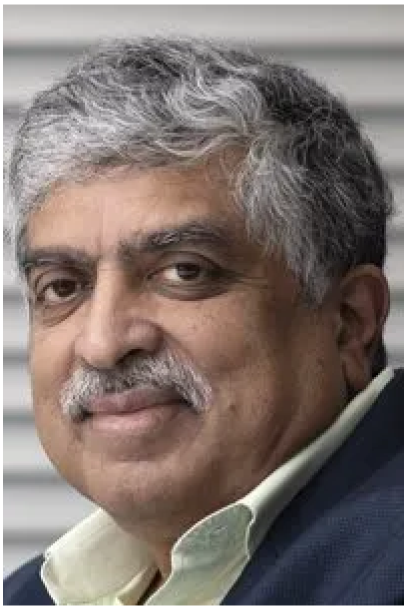
Infosys declined to comment, but has previously said that as it received no supporting evidence it was under no obligation to report the claims.

The company's decision to bring in outside executives such as Mr Parekh and Mr Roy — who joined from Indian telecoms company Bharti Airtel — rather than pick a candidate from within Infosys's 200,000-strong workforce rankled with some. "Culturally, this is wrong," that investor said.

But many analysts said portions of the whistleblower complaints reflected at least in part unease about the changing nature of the business model at Infosys, which is midway through a three-year strategic transformation.

For example, they said a claim that the management took on clients in deals with low or no margins points to the industry's increasingly competitive nature — where newer players have gladly sacrificed margin to win contracts.

"You have to buy the deal, as it were. The bet is that you'll start making money in the latter part of the contract," said Sid Pai, a technology consultant and former IT industry executive. "It's not something I used to see in the early days. But today it's *de rigueur*."



Co-founder Nandan Nilekani urged patience while an investigation by a law firm runs its course © Bloomberg

Infosys's margins shrank by 270 basis points in the two years ended in March, according to brokerage Motilal Oswal.

Before the latest allegations surfaced, Infosys's more aggressive strategy appeared to be bearing fruit. It had signed almost $3bn worth of large deals in the quarter ended in September, while revenues from "digital" business such as artificial intelligence and cloud services had grown 38 per cent from a year earlier. Its shares had risen to an all-time high.

The latest allegations have exacerbated concerns that Infosys will lose ground to competitors like Tata Consultancy Services. TCS has also enjoyed superior growth over the past decade, according to Credit Suisse, allowing it to steer clear of lower-margin deals.

While TCS's return on capital employed has risen over the past decade, Infosys' has halved.

After going on the offensive against rumour-mongers, Mr Nilekani expressed hope that the business he had helped create would soon return to form.

"Anybody can make allegations," he said. "Even God cannot change the numbers of this company."

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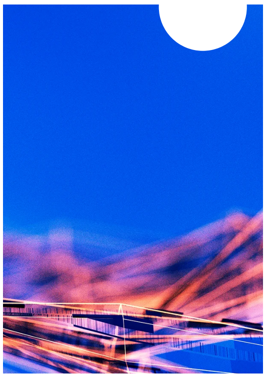

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