Sunbeam corporation and chainsaw al assignment

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OTTAWA UNIVERSITY FINANCE ADMINISTRATION POST-CLASS ASSIGNMENT MODULE 5 FAHRIAN C. H. CHOE STUDENT ID: 128370 MELAKA # 03 DUE: JULY 5, 2004 FINAL CASE IN FINANCIAL DECISION MAKING SUNBEAM CORPORATION AND CHAINSAW AL Prepared For Richard Brewington Instructor Ottawa University International Prepared by Fahrian C. H. Choe Student Ottawa University International June 30th, 2004 CONTENTS Page Executive Summary……………………………………………………….. i Introduction…………………….. …………………………………… 1 Dunlap’s Action Plan………………………………………………….. 2 Accounting Practices Raise Questions…………………………………. Lawsuit ………………………………………………………………… 5 Discussion……………………………………………………………… 6 Conclusion ……………………………………………………………. 9 Reference ……………………………………………………………… 10 Executive Summary This report is based on Sunbeam Corporation and Albert Dunlap, the CEO from 1996 till 1998. In July of 1996, Michael Price and Michael Steinhardt hired Dunlap as the CEO and chairman of the board for Sunbeam Corporation. As two of the original investors who bought Sunbeam from bankrupt Allegheny International, Price and Steinhardt together own 42 percent of its stock.

Prior to hiring Dunlap they had tried, unsuccessfully, to sell Sunbeam. They believed that he was the one person who could turn the company around and increase stock prices and profits. The increase in stock prices did occur, almost instantly. The turnaround took just fifteen months. On July 19, 1996, the day Dunlap was named chairman and CEO of Sunbeam, the stock jumped 49 percent. The jump increased the share price from 12 ? to 18 5/8,

adding $500 million to Sunbeam’s market value. The stock continued to increase and reached a record high of $52 per share in March 1998.

Corporate turnaround specialist Al Dunlap, whose penchant for slashing jobs earned him the nickname “ Chainsaw Al,” His plan involved massive cuts to the company’s product lines, plant closings and major cutbacks in the number of employees at Sunbeam. He called for the same types of cutbacks at previous companies he headed, including Scott Paper. As head honcho at Scott Paper, Sunbeam and other once-sleeping giants, Dunlap has turned around balance sheets with dramatic speed and results. Dunlap had built quite a reputation for himself.

He was well regarded by Wall Street and the investment community for his track record in dramatically boosting shareholder value at troubled companies. To investors who made millions by following him, Dunlap was, if not a god, certainly a savior (2). In 1997, on the basis of Sunbeam’s financial statements, it appeared that Sunbeam’s turnaround had been accomplished. In 1998 Sunbeam began a series of acquisitions of Coleman Inc. , First Alert Inc. , and Mr. Coffee, all synergistic businesses related to Sunbeam’s core businesses. In the first Quarter of 1998 the stock hit its all-time high of $52 per share.

By June 1998, the company’s directors had fired Dunlap, commenting that they had lost confidence in his leadership abilities. Dunlap’s dismissal comes less than two years after the company recruited him. Three years later, Sunbeam was in bankruptcy court and by May 2001 Dunlap was charged with fraud by the SEC. Dunlap was charged with orchestrating a fraudulent

scheme to create the illusion of the successful restructuring of Sunbeam and facilitate the sale of the Company at an inflated price. (1) By September 2002, Dunlap had been banned from ever serving as an officer or director of a public company.

He also was required to pay a $500, 000 fine. (The New York Times; September 5, 2002). By December 2002, the company announced that it had emerged from Chapter 11 bankruptcy protection. This announcement came with a name change for the company, from Sunbeam Corporation to American Household Inc (The New York Times; December 19, 2002). The purpose of finance is to maximize shareholders wealth. How did pressures for financial performance contribute to an organizational culture that tried to manipulate quarterly sales and to influence investors?. Introduction

When John Stewart and Thomas Clark founded the Chicago Flexible Shaft Company in Dundee, Illinois, in 1897, they probably never expected the company would be facing ethical and financial dilemmas more than a century later. Like many corporations, the firm has changed and faced many crises. It has acquired rival companies, added totally new product lines, changed its name, gone through bankruptcy, gone public, rebounded, restructured and relocated. Sunbeam is a well-known and recognized designer, manufacturer, and marketer of consumer products.

Sunbeam products are considered household staple items and are known for their use in cooking, health care, and personal care. Over its 100 years of operation, Sunbeam has grown and changed according to societal needs. It operates facilities in Canada, England, Hong Kong, Mexico, the US, and

Venezuela. In June of 1996, Sunbeam Corporation needed help. Its earnings had been rapidly declining since December 1994, and by 1996, the stock was down 52 percent and earnings had declined by 83 percent. Sunbeam also had 12, 000 employees as well as 26 factories worldwide, 61 warehouses, and 6 headquarters.

This when Albert Dunlap also known as " Chainsaw Al came into the picture. He received his reputation as one of the country's meanest executives because he ruthlessly eliminated thousands of jobs. He was known for his ability to restructure and turn around troubled companies. His philosophy was deficient in regards to ethical responsibility. Shareholder wealth, at any cost, was his only goal. Dunlap's Action Plan In order to make money for shareholders, Dunlap created and followed four simple rules of business.

Get the right management team, cut back to the lowest costs, focus on the core business and get a real strategy. In following those four rules, Dunlap helped turn around companies in seventeen states and across three continents. The champion move he made was to work on the first step of his four simple rules of business, get the right management team. Once the first step had been accomplished, Dunlap and the " Dream Team" for Sunbeam quickly went into action implementing the second rule. The second of Dunlap's four simple rules is to cut back to the lowest costs.

As expected, and true to his reputation, layoffs occurred. After less than four months as the chairman and CEO of Sunbeam, Dunlap announced plans to eliminate half of the 12, 000 worldwide employees. Another method used by Dunlap to cut back to the lowest costs was to reduce the number of SKUs

(stock keeping units) from 12, 000 to 1, 500. The reduction of SKU enabled Dunlap to eliminate unneeded factories and warehouses, which was another cost-savings method. This made it possible to reduce the number of headquarters locations. The third step was to focus on Sunbeam's core business, which first needed to be defined.

Dunlap defined the core business as electric appliances and appliance-related businesses. Five categories surrounding the core business were identified as vital to Sunbeam's success: kitchen appliances, health and home, outdoor cooking, personal care and comfort, and professional products. All products that did not fit into one of these five categories were sold. The final of Dunlap's four simple rules of business is to get a real strategy. Dunlap and his team defined Sunbeam's strategy as driving growth of the company through core business expansion by further differentiating products, moving into new geographical areas, and ntroducing new products that tied directly to emerging customer trends as lifestyles evolve around the world. Each of Dunlap's four rules had been reviewed and changes had been made within seven months of his taking the position to complete the turnaround of Sunbeam. The stock had risen to over $48 per share, a 284 percent increase since July 1996. In October 1997, just 15 months after accepting the position as chairman and CEO, Dunlap issued a press release stating the turnaround was complete and was looking for a buyer for Sunbeam.

Unable to get the price he wanted, Dunlap decided to invest by purchasing companies. On March 2, 1998, Sunbeam acquired 82 percent of Coleman (camping gear), Signature Brands (Mr. Coffee) and First Alert (smoke and gas

alarms). Two days after these purchases were announced; Sunbeam's stock jumped to a record high of $52 a share. With share prices the highest they had ever been and 1997 net income reported at $109. 4 million, Sunbeam truly seemed to have turned the corner, at least on paper. Dunlap accomplished what he set out to do at Sunbeam, but the shareholder wealth did not last..

Sunbeam is again facing rough times. Soon after the purchases, rumors began emerging that the three purchases were made to disguise losses through write-offs. On Saturday, June 13, 1998, the board of directors agreed that their confidence in Dunlap and his ability to turnaround Sunbeam was lost, stating his immediate departure would be necessary. Chainsaw Al was told that same day, via a one-minute conference call, that he was the next person to be cut at Sunbeam. Accounting Practices Raise Questions Paine Webber Inc. analyst Andrew Shore had been following Sunbeam since the day Dunlap was hired.

Shore had been scrutinizing Sunbeam's financial statements every quarter and considered its reported levels of inventory for certain items to be high for the time of year. He noted massive increases in sales of electric blankets in the third quarter, which usually sell well in the fourth quarter. He also found it odd that sales of grills were high in the fourth quarter, an unusual time of year for grills to be sold, and noted that accounts receivable were high. On April 3, 1998, hours before Sunbeam announced a first quarter loss of $44. 6 million, Shore downgraded the stock.

By the end of the day Sunbeam's stock price fell 25 percent. Dunlap had been using a " bill and hold" strategy with retailers, which boosted Sunbeam's revenue, at least on the balance sheet. A " bill and hold" strategy involves selling products for large discounts to retailers and holding them in third-party warehouses to be delivered at a later date. In essence, the strategy shifts sales from future quarters to the current one. By booking sales months prior to the actual shipment or billing, Sunbeam was able to report higher revenues in the form of accounts receivable, which inflated its quarterly earnings.

In 1997, the strategy helped Dunlap boost Sunbeam's revenues by 18 percent. A " bill and hold" strategy is not illegal and follows the General Accepted Accounting Principals (GAAP) of financial reporting. Even though the " bill and hold" strategy is not illegal, many shareholders felt the company had deceived them so they would purchase Sunbeam's artificially inflated stock. Several decided to file lawsuits alleging that the company made misleading statements about its finances. Lawsuit A class- action lawsuit was filed on April 23, 1998, naming both Sunbeam and its CEO as defendants.

The lawsuit alleged that Sunbeam and Dunlap violated federal securities laws by misrepresenting and or omitting material information concerning the business operations, sales, and sales trends of the company. The lawsuit also charged that the motivation to artificially inflate the price of the common stock was so Sunbeam could complete hundreds of millions of dollars of debt financing to complete the mergers with Coleman, First Alert, and Signature

Brands. Sunbeam’s subsequent reporting of earnings significantly below the original estimate caused a huge drop in the stock.

The Securities and Exchange Commission filed a civil injunctive action in U. S. District Court in Miami, Florida, against Dunlap and four other former officers of Sunbeam. The Commission alleges that the Defendants engaged in a scheme to fraudulently misrepresent the Company’s results of operations in connection with a purported “ turnaround” of the Company. When Sunbeam’s “ turnaround” was exposed as a sham, the stock price plummeted, causing investors billions of dollars in losses. 4) Albert Dunlap agreed to pay $500, 000 to settle Securities and Exchange Commission charges that he defrauded investors by inflating sales at the largest U. S. maker of small appliances. The SEC alleged. “ Dunlap was the guiding presence at Sunbeam when it did a panoply of things wrong,” SEC assistant enforcement director Richard Sauer said in an interview. A number of Sunbeam’s accounting irregularities, which included using “ cookie-jar” reserves to exaggerate the company’s turnaround from 1996 to 1998, have “ echoes” in more recent accounting cases at Enron Corp. nd WorldCom Inc. Sauer said. Sunbeam’s auditor was Arthur Andersen LLP, which also audited the books at Enron and WorldCom. (3) Discussion Dunlap authored a book entitled Mean Business where he stressed that making money for shareholders is the most important goal of any business. When he was hired by Sunbeam to turn the fortunes around, Dunlap’s concern was only maximizing shareholders wealth. Dunlap used the four simple rules of business which helped turn around companies in seventeen states and across three continents. The four simple rules however could not help

Sunbeam. Chainsaw Al Dunlap," earned his nickname for his propensity to recklessly slash jobs. His poor management decisions tanked company stock value, sparked shareholder lawsuits and prompted a federal investigation into company accounting practices. Dunlap insisted for results and in desperation several management staff manipulated the accounts so as to show greater profit. Good profit news can light a fire under a company's stock. Most of Sunbeam's senior executives have compensation packages tied to stock-price and earnings targets.

Investors profit by correctly divining which companies will meet or exceed expectations and which will fall short. As for accounting firms, if they help a company meets its numbers, sometimes by ignoring or even suggesting, some pretty dubious bits of bookkeeping; then they can usually count on retaining the company's lucrative auditing business and maybe pick up a consulting contract as well. But for all the attention paid to the quarterly profit, it's not much use in predicting a company's future performance and future cash flows, theoretically the basis for determining the value of a share of stock.

Quarterly profit report says next to nothing about a company's prospects beyond the next quarter and even over such a short time horizon, the report's predictive value is severely limited. For a company that's trying to position itself as a turnaround story or as a fast-growing superstar, even one bad quarter is one too many. In such cases, a company may stretch its ingenuity and accounting standards to the limit in order to put the best possible face on disappointing results. It may resort to " borrowing" sales and profits from the next quarter to cover a shortfall in the current quarter.

One popular tactic is selling goods to customers who aren’t ready to buy yet. To make the deal attractive to the buyer, the seller often finances the purchase interest free and, in some cases, picks up the cost of storing the goods until the customer is ready to take delivery. It often appears harmless, a matter of offering a few customers incentives to place an order a little ahead of schedule. But that seemingly innocent practice can get out of hand. The trouble with borrowing future sales to pad current results is, of course, that the loan must eventually be repaid.

Companies often plan to square accounts as soon as business picks up. But sometimes business never improves, and the deception becomes more and more difficult to disguise. That’s what happened at Sunbeam. When summer rolled around, its customers already had all the grills they needed, so the company had no fresh revenue in which to bury the sales it had borrowed during the winter. From the last quarter of 1996 until June 1998, Sunbeam Corporation’s senior management created the illusion of a successful restructuring of Sunbeam in order to inflate its stock price and thus improve its value as an acquisition target.

The management employed numerous improper earnings management techniques to falsify the Company’s results and conceal its deteriorating financial condition. In June 1998, negative statements in the press about the Company’s sales practices prompted Sunbeam’s Board of Directors to begin an internal investigation. This resulted in the termination of certain members of senior management, including Sunbeam’s chief executive officer and chief financial officer, and, eventually, in an extensive restatement of the

Company’s financial statements from the fourth quarter of 1996 through the first quarter of 1998.

As a result, Sunbeam’s restated 1997 income was approximately one-half of the amount previously reported. Conclusion Flexibility, the great virtue of most accounting systems as practiced in most of the developed world, is also those systems’ weak point. In honest hands, most accounting systems are up to the job of providing a reasonably accurate rendering of a business’s financial performance. Accuracy, however, is not always the aim of those who manage a corporation or stand to gain from ooperating with management, be they board members or outside accountants, analysts or investment bankers. All may have an interest in manipulating the accounting system to produce a misleading, distorted, or downright fictional portrayal of a business’s health and prospects. Companies like Enron and others have shown how easy it is to manipulate companies’ financial statements. Maximizing shareholders wealth is important but it should not be at the expense of manipulating the financial performance of the company. Reference 1) R. Laing, Jonathan. June 8, 1998) Did “ chainsaw al” dunlap manufactured sunbeam’s earnings last year? Available online : http://www. kellogg. nwu. edu/faculty/hayes/ftp/Articles/sunbeam_barrons. html 2) Chainsaw al, He anointed himself America’s best CEO. but al dunlap drove sunbeam into the ground. Businessweek On-line (Oct 18, 1999) Available online : http://www. businessweek. com/1999/99_42/b3651099. htm 3) Roland, Neil & Mathewson, Judy. (September 4, 2002) Sunbeam ex-CEO ‘ chainsaw al’ dunlap settles SEC case. Washington Bloomberg News. Available online : http://securities. tanford.

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