Tyco international-corporate malfeasance

Business, Corporate Governance

Tyco began in 1960 when it was founded by Arthur Rosenberg and started as an investment holding firm. In 1973 Joseph Gaziano took over for Rosenberg as CEO and pursued many hostile acquisitions. He was successful and was able to grow the company to a net worth of $140 million before he passed away in 1982. The CEO who took his place was John Fort who came in with the basic strategy of maximizing shareholder wealth through dramatically cutting costs. When John Fort left his position in 1992, Tyco was comprised of Fire Protection, Electronics, and Packaging departments.

Dennis Kowalski was able to work his way to the top of Tyco and take the CEO position in 1992. Kowalski began as an aggressive CEO looking to acquire businesses that were in synergy with Tyco. He succeeded with this by diversifying the company with 1, 000 acquisitions by 2002. Throughout the peak of his reign at Tyco the stock price soared from only $5. 00 in 1992 to $62. 00 in 2001. Although, what investors did not know and should have legally known, was that Kowalski and Swartz had so much influence over the board of directors that they were able to hide substantial amounts ofmoneywhich they gave to executives throughout the company.

In the end, Kowalski stepped down as CEO in June of 2002 when it became evident that he was stealing money from the company. He and Swartz (CFO) were convicted of grand larceny, conspiracy, and fraud and were sentenced to 8-25 year prison sentences in June of 2005. This could have been prevented if the corporate governance structure was not so overpowered by these two individuals. Situational Analysis Industry Attractiveness Analysis Tyco now has many different main industries that it does business in.

Although, there is not enough space to cover all of them so I will use two of the most important industries.

They are fire protection, and electronics industries. It is very important to use the five forces of competition model when looking at the attractiveness of both of these industries. The five forces of competition model includes the threat of new entrants, bargaining power of suppliers, bargaining power of buyers, rivalries among firms, and the threat of substitute products. The fire protection industry seems to have a mediocre barrier to entry for new firms entering the industry. This industry is a mature one where firms have already established themselves in the market place and therefore it would be hard for new entrants to be profitable.

Although, there is a chance that a new entrant will have a core competency in their product in the form of a unique fire protectiontechnologythat is hard for other firms to imitate. Since the demand for fire protection equipment is relatively stable and there are many firms in the industry, the bargaining power of suppliers is relatively low. The bargaining power of buyers is mediocre because firms produce many differentiated and unique fire protection devices. These customers could also go and switch to a substitute product and not incur much more of a cost.

Therefore, the threat of substitute products is high in the fire protection industry. The fire protection industry is very competitive and companies strive to differentiate themselves from competitors. Therefore, this industry has an intense rivalry among competitors. Overall, Tyco should still compete in this industry because of the constant demand and the potential to have a product go above and beyond expectations. The electronics industry is very competitive, in which firms must concentrate on constantly making their products better.

Once a firm is established in this industry, like Tyco, there is no significant threat that new entrants pose. This is because a new entrant would get a very big competitive response right away from other innovative mature firms in the industry and not be able to gain a significant market share. Suppliers in this industry have a high degree of bargaining power because this industry is dominated by only a few very large firms. The bargaining power of buyers in this industry is very low because companies are constantly producing highly innovative and unique products.

The threat of substitute products in the electronics industry is high because there are always at least three competitors that produce the same types of products (televisions, video games). So, if a customer wanted to purchase another video game for his x-box he could very easily buy one without thinking about who made the game. Tyco should stay in this industry since they already have their foot in the door and are doing well. ExternalEnvironmentAnalysis It is also essential to understand the trends of the external environment and how they might affect Tyco.

These trends have different implications for the fire protection and electronic industries Tyco competes in. First off, demographically the people in our world are getting older due to the aging of the baby boomers. This is a negative signal for the electronics industry because the majority of buyers of electronics are relatively young. The fire protection industry is not affected so much because fire protection is a necessity now. When looking at the economic segment, we are climbing out of a recession and interest rates are low. Therefore Tyco is able to borrow capital at lower rates than before.

Also, the political/legal segment may affect the electronic and fire protection industries in a number of different ways. Some laws may affect changes in interest rates and would give Tyco a higher or lower cost of capital. Also, there may be politics or groups of people that lobby against them and portray a negative image of Tyco to shareholders. In effect, this would reduce the stock price. Another factor of the external environment that must be considered is the sociocultural segment which deals with the attitudes and theculturepeople Tyco might do business with.

If Tyco were to expand into other countries it would need to consider their culture because certain products may not be marketable to them. One of the most important segments for Tyco to consider is the technology segment which is evolving rapidly today. Tyco must consider what other companies are inventing in both industries so they can better their own products to compete. I feel that there is turbulence in the economic and political/legal segments at the moment that may hinder Tyco's efforts in both industries. Consequently, Tyco must proceed with caution into the fire protection and electronic industries to earn an above average profit.

Internal Environment Analysis When looking at the internal environment of Tyco you should consider its resources (tangible and intangible), capabilities, and core competencies. Tyco's high borrowing capacity is an example of a key financial resource for them. They also have organizational resources in the board of directors where there is a compensation committee, an audit committee, and a nominating and governance committee. If the board committees were to work effectively, and not how they worked in the case, then this would be a key organizational resource for Tyco.

Also, Tyco was well known in the case for its human resources because they had CEOs who were well known and had substantial know how, and trust from the stakeholders. This was true until Kowalski became a bad human resource and betrayed the stakeholders trust by stealing money from them. Tyco’s CEOs also possessed innovation resources in the form of pursuing very profitable and creative acquisitions. Tyco also has capabilities in its human resources because they were able to retain top level executives and give them stock options to put their incentives in line with the incentives of the shareholders.

Kowalski also effectively used investment bankers to help him determine whether or not an acquisition would be profitable. A management capability skill that most of the CEOs had was the ability to cut costs to increase the bottom line. A core competency of Tyco under Kowalski was that they were able to exploit the opportunities of many acquisition candidates at one time. In fact, in the case it mentioned that Kowalski would be looking at 30-40 acquisitions at one time. This type of core competency falls under the valuable capabilities section. SWOT Analysis

Tyco must also asses its strengths, weaknesses, opportunities, and threats to get a better idea of what they are good at and what they might need to work on or look out for. Tyco has strengths in the form of being able to acquire businesses that fit well with the organization and will be profitable in the future. Also, Tyco had a great ability to cut costs under Kowalski and a few other CEOs that worked for the company. Shareholder confidence up to 1999 was also another strength Tyco had. Their main weakness existed in their governance structure in which Kowalski and Swartz were able to manipulate very easily.

Tyco has an opportunity in the form of more profitable acquisitions if the new CEO and board members would approve. Another opportunity they may want to explore is moving into international markets in growing countries such as China and India. A big threat to Tyco is that the stock holders may take a while to re-gain confidence in the company and as a result Tyco could be in financial trouble. Acquisitions and Corporate Governance Increasing Diversification Tyco began as a small investment holding firm in 1960 and has grow drastically ever since.

The four CEOs Tyco has had have diversified the business by obtaining companies through over 1, 000 acquisitions. They acquired firms that related to their three main departments which were fire protection, electronics, and packaging. For example, Tyco acquired firms such as Earth Technology Corporation, Carlisle, and Amp, which all three were in synergy with Tyco’s existing operations. In general Tyco pursued diversification because they wanted to reduce their dependence on only a few sources of revenue and realize income from various sources.

This is an effective way to manage income because in a recession some of the businesses within Tyco will do poor, while others will improve. The book says on page 190, "…research has shown that the more related the acquired firm is to the acquiring firm, the greater probability is that the acquisition will be successful. " This is evident in the case because when Kowalski entered as CEO in 1992 he was able to look at many companies for acquisition that were in synergy with Tyco. He did this with the help of investment bankers who told him weather or not an acquisition of a certain company would be profitable.

Once Kowalski started acquiring businesses that were in synergy with Tyco, the stock price started to soar and the company was making more than ever. Once Kowalski acquired these firms he would then cut costs by getting rid of employees and downsizing these companies. The cut costs and more product diversification led to higher than expected profits for the company which led to a growing stock price. The book specifically states on page 280, "…diversification usually increases the size of the firm, and size is positively related to executive compensation. Corporate Governance Tyco's corporate governance structure seemed to be fine until the era of Kowalski and Swartz. The executive compensation at Tyco consisted of mainly stock options which aligned manager's interests with those of their stockholders. In class this week we learned that boards should be made up of about half insiders and half outsiders to the company. Tyco's board of directors consisted of the following committees: a nominating and governance committee, an audit committee, and a compensation committee.

Since Tyco began to grow so rapidly, Kowalski was able to gain so much control that the TME's audit committee reported directly to him rather than to the boards audit committee. This created a situation where Kowalski could do whatever he wanted with Tyco’s money and hide the evidence from the board and the shareholders. This created a situation where the board was secretly being controlled by insiders and in the end led to a drop in Tyco’s stock price. This is an example of management opportunism which is explained by a manager who seeks self interests with guile.

This is also an agency problem because the interests of Kowalski and Swartz to hide money for their own benefit conflicts with the interests of stockholders to maximize the stock price. Swartz was able to help with the scheme of things because he was the CFO and was in control of fund transfers, accounting entries, and compensation plans in human resources. This led Kowalski and Swartz to manipulate the KELP loan program, which was created to help executives pay down taxes on gains from stock options. In 1999, the two of them were able to cut their KELP loan debts by $37. 5 million by controlling the accounting of Tyco.

Kowalski and Swartz misled the shareholders and the board so effectively that their modified accounting figures led them to believe that Tyco was profitable. In effect, this led to increases in the stock price. In 1999 and 1998 Tyco received bad press releases that hinted on their deceptive accounting practices. As a result, Kowalski and other big executives sold their shares, which nearly cut Tyco’s stock price in half. Their manipulations got so of hand that Kowalski gave Josh Berman a $20 million dollar bonus for finding a successful acquisition for Tyco that they only spent $5 million on.

This outraged investors and finally convinced Kowalski to step down from his throne and be indicted with tax evasion. This was a very sad way for Kowalski to end hiscareerbut he very much deserved it after what he did. Recommendation Tyco is a very well rounded company and is diversified enough to stay around for a while. They need to look into their corporate governance structure more carefully and try to put some internal controls in place that will prevent disasters like this one form happening. I suggest that they should put more external people on the board of directors to keep it from getting manipulated.

They also need to be very conscious about having the right people auditing the financial records of the company. I do not know if Tyco has tried going international, but if they have not I think it would be a great opportunity for them to gain more market share. Tyco would need to pick the product lines that best suited the country they were going into and be sure to have enough knowledge about the country’s culture and beliefs they are going into. Overall, I think Tyco could be very successful if they have the right combination of people, diversification, and culture throughout the company.