WorldCom Scandal Case: The Biggest Disappointment in the History of the Stock Market

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WorldCom’s Rise and the Expansion of a Telecommunications Empire

In 1983, a gym teacher, Bernard John Ebbers, founded a tiny telecommunication company, which reached 42nd place in the Fortune 500 companies and soon took over other large network providers such as UUNET, CompuServe, and America Online. Bernard’s company, WorldCom, soon became one of the leading internet infrastructure operators and one of the largest long-distance telephone service providers. An early investor and the founder of WorldCom became its chief executive officer (Lyke & Mark 2).

WorldCom became a noticeable business in the market and attracted many investors. The expansion and growth of the telecommunication company were extraordinary, and so was the rate of increase in its founder’s wealth. Ebbers was reported to be worth more than $500 million during the 2000s (CNBC). In 1998, WorldCom merged with MCI Communication Corp., worth $40 billion; this was followed by a dramatic increase in WorldCom’s shares in 1999. It is recorded to have reached $64. WorldCom’s sales surged to $8 billion at a growth rate of 14%. International revenues also rose by 55% (CNBC).

Starting with only about $650,000 of capital, the leading telecommunication operator soon accumulated a debt of $1.5 million because of the lack of expertise in handling the accounts of large companies. However, Ebbers, who had the experience of a bartender, milkman, and truck driver, led the company to incredible profits in less than a year. He focused on the internal growth of the organization. This strategy resulted in economies of scale crucial for the company’s expansion. WorldCom’s per-unit costs dropped significantly, and the company could generate revenue for mergers, which was Ebbers’s best strategy for the firm’s success (Kaplan, Robert S. & Davi).

Leadership, Share Price Pressure, and a Culture of Excessive Growth

The merely experienced CEO, Ebbers, always aimed for high revenues and increasing the capacity for future growth. He believed in raising the share value, which would lead to more investments and more revenue and profits, hence improving his wealth status. He is reported to have said that the firm's goals were not to capture the market share or expand globally but to be the top stock on Wall Street. The emphasis on revenues pushed WorldCom's employees to do anything necessary for more revenues, even if it included the long-term costs of a project outweighing the short-term gains.

The business's exceptional growth rate meant massive-scale operations in different locations with thousands of employees. A former WorldCom accountant recalled that there were offices and people in the organization he never learned about. The company's finance department maintained the corporate general ledger in the Mississippi headquarters. Ebbers was reported to have never included the legal department in the company's functions and how it operated. He never emphasized corporate laws and a code of conduct for the whole organization. The accounting department was also misguided and lacked rules and regulations to follow. Instead of providing the financial, accounting, and investor relations departments with a guide for the company's policies, they were rewarded beyond the approved salary and bonus guidelines. It was a form of bribe for them to avoid interfering in the internal auditing of the firm (Kaplan, Robert S. & Davi).

In 1999, WorldCom's attempt to merge with Sprint Corp. failed due to the U.S. Justice Department's termination of the merger. It proved to be one of the most significant events in the firm's history since large-scale mergers were no longer an option for expansion goals. It was obvious that the organization began to fall apart as it lacked a vision for the future and how it would be managed. The top management had issues and excluded most of its employees from internal affairs.

Accounting Manipulation and the Concealment of Operating Expenses

The firm could no longer meet its revenue goals in 2001. Scott D. Sullivan, Chief Finance Officer of WorldCom, asked his employees to maintain a 42% expense/revenue ratio, which was declared impossible considering the position at that time. Nevertheless, Sullivan came up with the solution of treating operating costs as capital expenditure, which is against international accounting principles, and set up a hoax for investors. This new method of accounting manipulated revenues and profits, showing them as much higher than the true values. Accounting managers Vinson and Troy were asked to treat $828 million of line accruals in the Income Statement. That is when the firm used unfair means for its success, breaking several laws.

External auditor Arthur Andersen claimed that WorldCom was a “high-risk” client for committing fraud. Andersen could easily identify the accrual reversals and capitalization of expenses from the general ledgers; however, WorldCom ignored its requests and kept important information from it. The press blamed Andersen for its irresponsibility and for turning a blind eye to the company’s abnormal financial statements (Yallapragada, RamMohan R., C. William Roe, & Alfred G. Toma 187).

In 2002, the U.S. Securities and Exchange Commission requested information from WorldCom regarding accounting procedures and loans offered to officers. On the 25th of June, the company announced that it would have to revise its financial statements as transactions worth $3.85 billion were misstated. The discovery shocked all the investors of WorldCom and disappointed many stakeholders. The next day, the U.S. SEC initiated a lawsuit against WorldCom for accounting fraud. The U.S. Department of Justice investigated the actions of CEO Bernie Ebbers, CFO Scott Sullivan, and a few other senior managers involved in the conspiracy.

Bankruptcy, Investigation, and the Consequences of Corporate Fraud

Further investigation into the firm’s actions revealed capitalization of more than $11 billion of operating expenses. The company soon filed for Chapter 11 bankruptcy (the purpose of Chapter 11 bankruptcy is to keep functioning in the market under court supervision) as investors pulled out their money, and its long-term corporate credit rating dropped from B+ to CCC-.

In 2005, Ebbers was found guilty after a six-week trial and sentenced to twenty-five years in prison, the longest sentence a CEO had ever received. Senior managers of WorldCom, including David Meyers, Yates, Vinson, and Normand, pleaded guilty to felony charges of securities fraud and making false filings. Scott Sullivan pleaded guilty, as well, to committing fraud, misleading his employees and WorldCom investors, and deceiving the SEC (Lyke & Mark 6).

WorldCom’s downfall is reported to be the biggest disappointment in the stock market’s history. Being a major contributor to the economy and one of the biggest telecom employers, WorldCom’s decline affected many stakeholders. The problem with the firm had been there since the beginning. The CEO’s intentions for personal gains, lack of expertise, and pressure on lower management led the firm into a conspiracy that is remembered to this day.

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