SHAW ACADEMY

Lesson 2 Practical Scandals and Leadership

Advanced Diploma in Leadership and Management

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Lesson 2 Practical: Scandals and Leadership

Lesson Pillars

Scandals
The Leaders
Corporate Governance – Sarbanes Oxley
What do you tale on board

Key Readings

BP Oil Spill http://www.telegraph.co.uk/news/worldnews/northamerica/usa/11546654/BP-oil-spill-Five-years-after-worst-environmental-disaster-in-US-history-how-bad-was-it-really.html

Blame BP for Deepwater Horizon. But Direct Your Outrage to the Actual Mistake.http://www.slate.com/articles/health_and_science/science/2016/09/bp_is_to_blame_for_deepwater_horizon_but_its_mistake_was_actually_years.html

Tony Heyward A Pariah https://www.theguardian.com/business/2014/may/08/tony-hayward-comback-bp-oil-spill-glencore-xstrata-chairman-gulf-of-mexico-disaster

United CEO Oscar Munoz Blames David Dao Incident on 'System Failure' http://www.nbcnews.com/news/us-news/united-ceo-oscar-munoz-blames-david-dao-incident-system-failure-n751661

United Airlines CEO Oscar Munoz won't be promoted to chairman http://money.cnn.com/2017/04/21/news/companies/united-airlines-oscar-munoz-chairman-board/index.html

Where are they now? The key figures in the collapse of Lehman Brothers http://www.telegraph.co.uk/finance/financetopics/lehman-brothers/11839951/Where-are-they-now-The-key-figures-in-the-collapse-of-Lehman-Brothers.html

25 People to Blame for the Financial Crisis http://content.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877326,00.html

Sarbanes-Oxley Act and the Enron Scandal - Why Are They Important? https://www.thebalance.com/sarbanes-oxley-act-and-the-enron-scandal-393497

The Role of the SOX Act in the U.S. Economic Crisis http://www.grcg.com/sox-and-the-financial-crisis/

Lesson Resources: Keep a Learning Log

It is recommended that you keep a learning log. Get a small personal notebook that you can use exclusively for this course. In it, you will record insights, thoughts, reflections on previous leadership and management experiences you may have had. During key learnings in the course you will be prompted to think about a time in your past when you observed, noted or reacted to a situation. The learning log will help to build a picture of your growing self-emergence as a leader and manager.

Pillar: Scandals

In this lesson, we discuss where were the leaders during the worst crises in recent times.

Where are our principled leader? In this lesson we investigate some notorious scandals and see the role that the leaders played in each. We look at Enron, BP Oil Spill in the Gulf of Mexico, Lehman Brothers Collaspe and most recently the awful treatment of a passenger n United Airlines. In each scandal, the CEOs played a principle role and we see how their leadership played out.

Scandals lacking leadership

Enron: The fall of the darling of Wall Street

Lehman Brothers: The CFO stated "the risks posed by rising delinquencies were well contained".

BP: Their CEO Tony Heyward was taking a day off to go sailing in the Solent as oil gushed into the Gulf of Mexico certainly didn't help either.

United Airlines: Treatment of passenger Dao showed the boss did not know all the facts.

Enron

Enron Corp. is a company that reached dramatic heights, only to face a dizzying collapse. The story ends with the bankruptcy of one of America's largest corporations. Enron's collapse affected the lives of thousands of employees and shook Wall Street to its core. At Enron's peak, its shares were worth $90.75, but after the company declared bankruptcy on December 2, 2001, they plummeted to $0.67 by January 2002. To this day, many wonder how such a powerful business disintegrated almost overnight and how it managed to fool the regulators with fake, off-the-books corporations for so long.

Enron participated by creating Enron Online (EOL), an electronic trading website that focused on commodities in Oct. 1999. Enron was the counterparty to every transaction on EOL; it was either the buyer or the seller. To entice participants and trading partners, Enron offered up its reputation, credit, and expertise in the energy sector. Enron was praised for its expansions and ambitious projects and named "America's Most Innovative Company" by Fortune for six consecutive years between 1996 and 2001.

By mid-2000, EOL was executing nearly $350 billion in trades. At the outset of the bursting of the dot-com bubble, Enron decided to build high-speed broadband telecom networks. Hundreds of millions of dollars were spent on this project, but the company ended up realizing almost no return.

When the recession began to hit in 2000, Enron had significant exposure to the most volatile parts of the market. As a result, many trusting investors and creditors found themselves on the losing end of a vanishing market cap.
CEO Jeffrey Skilling had a way of hiding the financial losses of the trading business and other operations of the company; it was called mark-to-market accounting. This is a technique used when trading securities where you measure the value of a security based on its current market value, instead of its book value. This can work well for securities, but it can be disastrous for other businesses.

For more see https://prezi.com/nqvf3yegbk3i/unethical-leadership-at-enron/

Lehman Brothers

On September 15, 2008, Lehman Brothers filed for bankruptcy. With $639 billion in assets and $619 billion in debt, Lehman's bankruptcy filing was the largest in history, as its assets far surpassed those of previous bankrupt giants such as WorldCom and Enron. Lehman was the fourth-largest U.S. investment bank at the time of its collapse, with 25,000 employees worldwide.

Lehman's demise also made it the largest victim of the U.S. subprime mortgage-induced financial crisis that swept through global financial markets in 2008. Lehman's collapse was a seminal event that greatly intensified the 2008 crisis and contributed to the erosion of close to $10 trillion in market capitalization from global equity markets in October 2008, the biggest monthly decline on record at the time.

Lehman's Colossal Miscalculation
In February 2007, the stock reached a record $86.18, giving Lehman a market capitalization of close to $60 billion. However, by the first quarter of 2007, cracks in the U.S. housing market were already becoming apparent as defaults on subprime mortgages rose to a seven-year high. On March 14, 2007, a day after the stock had its biggest one-day drop in five years on concerns that rising defaults would affect Lehman's profitability, the firm reported record revenues and profit for its fiscal first quarter. In the post-earnings conference call, Lehman's chief financial officer (CFO) said that the risks posed by rising home delinquencies were well contained and would have little impact on the firm's earnings. He also said that he did not foresee problems in the subprime market spreading to the rest of the housing market or hurting the U.S. economy.

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As the credit crisis erupted in August 2007 with the failure of two Bear Stearns hedge funds, Lehman's stock fell sharply. During that month, the company eliminated 2,500 mortgage-related jobs and shut down its BNC unit.

In addition, it also closed offices of Alt-A lender Aurora in three states. Even as the correction in the U.S. housing market gained momentum, Lehman continued to be a major player in the mortgage market. In 2007, Lehman underwrote more mortgage-backed securities than any other firm, accumulating an $85 billion portfolio, or four times its shareholders' equity. In the fourth quarter of 2007, Lehman's stock rebounded, as global equity markets reached new highs and prices for fixed-income assets staged a temporary rebound. However, the firm did not take the opportunity to trim its massive mortgage portfolio, which in retrospect, would turn out to be its last chance.

The stock plunged 77% in the first week of September 2008, amid plummeting equity markets worldwide, as investors questioned CEO Richard Fuld's plan to keep the firm independent by selling part of its asset management unit and spinning off commercial real estate assets. Hopes that the Korea Development Bank would take a stake in Lehman were dashed on September 9, as the state-owned South Korean bank put talks on hold.

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The History of Lehman Brothers

Lehman Brothers had humble origins, tracing its roots back to a small general store that was founded by German immigrant Henry Lehman in Montgomery, Alabama in 1844. In 1850, Henry Lehman and his brothers, Emanuel and Mayer, founded Lehman Brothers.

While the firm prospered over the following decades as the U.S. economy grew into an international powerhouse, Lehman had to contend with plenty of challenges over the years. Lehman survived them all – the railroad bankruptcies of the 1800s, the Great Depression of the 1930s, two world wars, a capital shortage when it was spun off by American Express Co. in 1994, and the Long Term Capital Management collapse and Russian debt default of 1998. However, despite its ability to survive past disasters, the collapse of the U.S. housing market ultimately brought Lehman Brothers to its knees, as its headlong rush into the subprime mortgage market proved to be a disastrous step.

The Prime Culprit

In 2003 and 2004, with the U.S. housing boom (read, bubble) well under way, Lehman acquired five mortgage lenders, including subprime lender BNC Mortgage and Aurora Loan Services, which specialized in Alt-A loans (made to borrowers without full documentation). Lehman's acquisitions at first seemed prescient; record revenues from Lehman's real estate businesses enabled revenues in the capital markets unit to surge 56% from 2004 to 2006, a faster rate of growth than other businesses in investment banking or asset management. The firm securitized $146 billion of mortgages in 2006, a 10% increase from 2005. Lehman reported record profits every year from 2005 to 2007. In 2007, the firm reported net income of a record $4.2 billion on revenue of $19.3 billion.

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The Beginning of the End

As the credit crisis erupted in August 2007 with the failure of two Bear Stearns hedge funds, Lehman's stock fell sharply. During that month, the company eliminated 2,500 mortgage-related jobs and shut down its BNC unit. In addition, it also closed offices of Alt-A lender Aurora in three states. Even as the correction in the U.S. housing market gained momentum, Lehman continued to be a major player in the mortgage market. In 2007, Lehman underwrote more mortgage-backed securities than any other firm, accumulating an $85 billion portfolio, or four times its shareholders' equity. In the fourth quarter of 2007, Lehman's stock rebounded, as global equity markets reached new highs and prices for fixed-income assets staged a temporary rebound. However, the firm did not take the opportunity to trim its massive mortgage portfolio, which in retrospect, would turn out to be its last chance.

Hurtling Toward Failure

Lehman's high degree of leverage – the ratio of total assets to shareholders equity – was 31 in 2007, and its huge portfolio of mortgage securities made it increasingly vulnerable to deteriorating market conditions. On March 17, 2008, following the near-collapse of Bear Stearns – the second-largest underwriter of mortgage-backed securities – Lehman shares fell as much as 48% on concern it would be the next Wall Street firm to fail. Confidence in the company returned to some extent in April, after it raised $4 billion through an issue of preferred stock that was convertible into Lehman shares at a 32% premium to its price at the time. However, the stock resumed its decline as hedge fund managers began questioning the valuation of Lehman's mortgage portfolio.

On June 9, Lehman announced a second-quarter loss of $2.8 billion, its first loss since being spun off by American Express, and reported that it had raised another $6 billion from investors. The firm also said that it had boosted its liquidity pool to an estimated $45 billion, decreased gross assets by $147 billion, reduced its exposure to residential and commercial mortgages by 20%, and cut down leverage from a factor of 32 to about 25.

Too Little, Too Late

However, these measures were perceived as being too little, too late. Over the summer, Lehman's management made unsuccessful overtures to a number of potential partners. The stock plunged 77% in the first week of September 2008, amid plummeting equity markets worldwide, as investors questioned CEO Richard Fuld's plan to keep the firm independent by selling part of its asset management unit and spinning off commercial real estate assets. Hopes that the Korea Development Bank would take a stake in Lehman were dashed on September 9, as the state-owned South Korean bank put talks on hold.

The news was a deathblow to Lehman, leading to a 45% plunge in the stock and a 66% spike in credit-default swaps on the company's debt. The company's hedge fund clients began pulling out, while its short-term creditors cut credit lines. On September 10, Lehman pre-announced dismal fiscal third-quarter results that underscored the fragility of its financial position. The firm reported a loss of $3.9 billion, including a write-down of $5.6 billion, and also announced a sweeping strategic restructuring of its businesses. The same day, Moody's Investor Service announced that it was reviewing Lehman's credit ratings, and also said that Lehman would have to sell a majority stake to a strategic partner in order to avoid a ratings downgrade. These developments led to a 42% plunge in the stock on September 11.

On Monday September 15, Lehman declared bankruptcy, resulting in the stock plunging 93% from its previous close on September 12.

Read more: Case Study: The Collapse of Lehman Brothers
http://www.investopedia.com/articles/economics/09/lehman-brothers-collapse.asp#ixzz4k4mK72Lb

BP Cover Up

The Deepwater Horizon oil spill began on April 20, 2010, in the Gulf of Mexico on the BP-operated Macondo Prospect. Killing eleven people, it is considered the largest marine oil spill in the history of the petroleum industry. The US Government estimated the total discharge at 4.9 million barrels (210 million US gal; 780,000 m. After several failed efforts to contain the flow, the well was declared sealed on September 19, 2010.

That BP lied about the amount of oil it discharged into the gulf is already established. Lying to Congress in 2012 about that was one of 14 felonies to which BP pleaded guilty last year in a legal settlement with the Justice Department that included a $4.5 billion fine, the largest fine ever levied against a corporation in the U.S.

Numerous investigations explored the causes of the explosion and record-setting spill.
Notably, the U.S. government's September 2011 report pointed to defective cement on the well, faulting mostly BP, but also rig operator Transocean and contractor Halliburton.
Earlier in 2011, a White House commission likewise blamed BP and its partners for a series of cost-cutting decisions and an inadequate safety system, but also concluded that the spill resulted from "systemic" root causes and "absent significant reform in both industry practices and government policies, might well recur".

BP's cover-up was not planned in advance but devised in the heat of the moment as the oil giant scrambled to limit the PR and other damages of the disaster. What has not been revealed until now is how BP hid that massive amount of oil from TV cameras and the price that this “disappearing act” imposed on cleanup workers, coastal residents, and the ecosystem of the gulf. That story can now be told because an anonymous whistleblower has provided evidence that BP was warned in advance about the safety risks of attempting to cover up its leaking oil. Nevertheless, BP proceeded. Furthermore, BP appears to have withheld these safety warnings, as well as protective measures, both from the thousands of workers hired for the cleanup and from the millions of Gulf Coast residents who stood to be affected.

http://www.telegraph.co.uk/news/worldnews/northamerica/usa/11546654/BP-oil-spill-Five-years-after-worst-environmental-disaster-in-US-history-how-bad-was-it-really.html

United Airlines

The forcible removal of a passenger from a United Airlines flight was a “mistake of epic proportions”, the airline's chief executive Oscar Munoz has admitted to US politicians.

“This is a turning point for United and our 87,000 professionals,” he told a hearing of the transportation committee of the House of Representatives in Washington DC.

“It is my mission to ensure we make the changes needed to provide our customers with the highest level of service and the deepest sense of respect.” “It was a mistake of epic proportions, clearly, in hindsight.”

Background

Mr Dao was waiting to fly from Chicago to Louisville, Kentucky, on 9 April when the airline decided it needed four seats on his flight for Republic Airline crew members needed to work on a United Express flight in Louisville the next morning.

When Mr Dao and his wife were selected for bumping, he refused to leave and was then dragged off the flight, suffering injuries that his attorney has said included lost teeth, a broken nose and a concussion.

Video of the incident sparked withering criticism and mockery of United online and in the media. Videos depicting the incident and Dao's injuries were widely circulated, and United Airline's shares declined. In a second press release on April 11, which was more sensitive to public opinion, Munoz "deeply apologized to the customer forcibly removed and to all other customers aboard."

CEO Oscar Munoz

Munoz's handling of the incident was described by various critics as a "fumbling response," a "major disappointment," and a "sort of a self-immolation that makes you wonder about his choice as CEO." Munoz was already under pressure from activist shareholders to improve United's performance, including its customer relations, after he took charge of the airline in 2015.
The company also revealed Friday that a new 2017 compensation program for Munoz, along with that of other executives, will be more closely tied to improved customer satisfaction. United said it wants "directly and meaningfully progress in improving the customer experience."
Related: No one has been fired over passenger incident
As part of Friday's disclosure, United also released its annual compensation figures for its top executives. Munoz received a total of $18.7 million, including $6.8 million related to replacing his equity stake that he held when he was president of railway CSX.
United declined to comment.

Dao dragged, bloodied and screaming, off an aircraft after he refused to give up his seat for commuting crew members. The company's first response, attributed to Munoz, did not go over well. He issued a statement that apologized only for "having to re-accommodate ... customers."

A second statement called the victim, Dr. David Dao "disruptive and belligerent." And finally a third statement from Munoz reversed course, decrying the situation and calling it a "truly horrific event," and offered a direct apology to Dao.

Dao's lawyers have said he plans to file a lawsuit.

Munoz took the top spot at United in 2015 during trying times for the company. He was hired as CEO from outside the company after its former chief, Jeff Smisek, was forced to resign due to a scandal involving the Port Authority of New York and New Jersey.
Shortly after he took the reins, Munoz suffered a heart attack and underwent a heart transplant, which kept him out of the office for two months.

Munoz has further defended the policy of overbooking, saying it helps the airline better serve passengers. You wonder if anything has been learnt at all.

The Leaders

In 2006, **Kenneth L. Lay**, the former chairman and chief executive of Enron who was convicted of fraud and conspiracy in the giant energy company's collapse, died today at his home in Aspen, Colo. He was 64.

“Hi, I’m **Dick Fudd**, the most hated man in America.” Dick Fuld was the chief executive officer who, on Sept. 15, 2008, led Lehman Brothers into the largest bankruptcy in U.S. history, setting a torch to the global financial system.

Tony Heyward The company’s British CEO earned himself the moniker of the “most hated man in America” for a stunningly ill-judged comment during a visit to the Gulf to try to placate locals when he apologised for the “massive disruption” to their lives, but then added: “There's no one who wants this over more than I do. I'd like my life back.“

In an email to United employees, **Oscar Munoz** stated that he stood behind employees for having "followed established procedures" and said that Dao was "disruptive and belligerent". confident of future performance.

Sarbanes Oxley: Does Goverance Work

Congress hastily passed SOX in the summer of 2002, following the implosions of Enron and WorldCom. The idea was to force firms and their auditors to clean up their books and to disclose their “internal controls” and procedures for ensuring the accuracy of their financial reporting.

“It is becoming increasingly clear that something has gone wrong, seriously wrong, with respect to our capital markets. We confront an increasing crisis of confidence that’s eroding the public’s trust in those markets.” So Sarbanes-Oxley was passed to establish “confidence” and “trust.” Did it achieve its objective? From the perspective of the subsequent financial panic of 2007-2009, Sarbanes’s idea of what the act would achieve needs no further comment.

The purpose of Sarbanes-Oxley Act (SOX) to protect shareholders and the general public from accounting errors and fraudulent practices in enterprises, and to improve the accuracy of corporate disclosures. The act sets deadlines for compliance and publishes rules on requirements. Congressmen Paul Sarbanes and Michael Oxley drafted the act with the goal of improving corporate governance and accountability, in light of the financial scandals that occurred at Enron, WorldCom, and Tyco, among others.

All public companies now must comply with SOX, both on the financial side and on the IT side. The way in which IT departments store corporate electronic records changed as a result of SOX. While the act does not specify how a business should store records or establish a set of business practices, it does define which records should be stored and the length of time for the storage. To comply with SOX, corporations must save all business records, including electronic records and electronic messages, for “not less than five years.” Consequences for noncompliance include fines or imprisonment, or both.

However, large firms’ financial officers, surveyed in 2007, said their companies spent an average of $1.7 million each to comply with SOX (compared with an initial sec estimate of five hours per report!).

All Sarbanes-Oxley's efforts to control risk did not avoid the tremendous financial bubble and bust of the last several years.

Did it work

When Peregrine Financial collapsed earlier this month, a nagging question resurfaced. As in the implosion of Lehman Brothers, the fall of Bernard Madoff and other cases in recent years, many asked: Where were the accountants?

That this question still arises could be seen as an indictment of the 2002 Sarbanes-Oxley law, enacted 10 years ago on Monday. The law was a response to accountants' failures to sound the alarm about financial misconduct at Enron Corp, WorldCom and a host of other companies.

But, lawyers and analysts say that for the most part Sarbanes-Oxley is working. It has strengthened auditing, made the accounting industry a better steward of financial standards, and fended off Enron-sized book-cooking disasters.

Yes, it has fallen short in important ways, but these failures are on a more subtle level, the experts say.

The law, signed by President George Bush on July 30, 2002, created a new auditor watchdog, the Public Company Accounting Oversight Board (PCAOB). The law strengthened internal controls over companies' accounts and set stiff criminal penalties for executives who cook the books. One of its toughest provisions required corporate executives to certify the accuracy of financial statements and imposed jail terms of up to 20 years for willful violations.

While only a handful of people have faced criminal charges over false statement certification, the Securities and Exchange Commission has invoked that part of Sarbanes-Oxley to bring more than 200 civil cases.

Recap: Dimensions of transformational leadership

Role Models

Transformational leaders act as role models and display a charismatic personality that influences others to want to become more like the leader. Idealized influence can be most expressed through a transformational leader's willingness to take risks and follow a core set of values, convictions and ethical principles in the actions he takes. It is through this concept of idealized influence that the leader builds trust with his followers and the followers, in turn, develop confidence in their leader.

Inspires

Inspirational motivation refers to the leader's ability to inspire confidence, motivation and a sense of purpose in his followers. The transformational leader must articulate a clear vision for the future, communicate expectations of the group and demonstrate a commitment to the goals that have been laid out. This aspect of transformational leadership requires superb communication skills as the leader must convey his messages with precision, power and a sense of authority. Other important behaviors of the leader include his continued optimism, enthusiasm and ability to point out the positive.

Empowers creativity and autonomy

Transformational leadership values creativity and autonomy among the leader's followers. The leader supports his followers by involving them in the decision-making process and stimulating their efforts to be as creative and innovative as possible to identify solutions. To this end, the transformational leader challenges assumptions and solicits ideas from followers without criticizing. She helps change the way followers think about and frame problems and obstacles. The vision the leader conveys helps followers see the big picture and succeed in their efforts.

Focus is in the follower

Each follower or group member has specific needs and desires. For example, some are motivated by money while others by change and excitement. The individualized consideration element of transformational leadership recognizes these needs. The leader must be able to recognize or determine --- through eavesdropping or observation --- what motivates each individual. Through one-on-one coaching and mentoring, the transformational leader provides opportunities for customized training sessions for each team member. These activities allow team members to grow and become fulfilled in their positions.

The methods that transformational leaders might use to reach their goals can vary. They'll virtually always include involving followers in the goal, as well as charisma, which comes, if not from personal characteristics, from the ability to put a mutual vision into words, and to move a group toward the realization of that vision. Transformational leaders may also use sharing power, setting an example, and/or persuasion to help move a group toward its goal.

Determine your own ethical standards

Here are some ethical leadership characteristics that will help you remain on the straight and narrow:

Justice

An ethical leader is always fair and just. They have no favorites, and treat everyone equally. Under an ethical leader, no employee has any reason to fear biased treatment on the basis of gender, ethnicity, nationality, or any other factor.

Respect others

One of the most important traits of ethical leadership is the respect that is given to followers. An ethical leader shows respect all members of the team by listening to them attentively, valuing their contributions, being compassionate, and being generous while considering opposing viewpoints.

Honesty

It goes without saying that anyone who is ethical will also be honest and loyal. Honesty is particularly important to be an effective ethical leader, because followers trust honest and dependable leaders. Ethical leaders convey facts transparently, no matter how unpopular they may be.

Teambuilding and collaboration

Ethical leaders foster a sense of community and team spirit within the organization. When an ethical leader strives to achieve goals, it is not just personal goals that they're concerned about. They make genuine efforts to achieve goals that benefit the entire organization – not just themselves.

Value driven decision-making

In ethical leadership, all decisions are first checked to ensure that they are in accordance with the overall organizational values. Only those decisions that meet this criterion are implemented.

Leadership by example

Ethical leadership is not just about talking the talk, this type of leader also walks the walk. The high expectations that an ethical leader has of employees are also applicable on the individual level. Leaders expect others to do the right thing by leading from example.

No tolerance for ethical violations

An ethical leader expects employees to do the right thing at all times, not just when it is convenient for them. Don't expect a leader of such high values to overlook or tolerate ethical violations.

Value awareness

An ethical leader will regularly discuss the high values and expectations that they place on themselves, other employees, and the organization. By regularly communicating and discussing values, they ensure that there is consistent understanding across the organization.

Thank
you

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