

2015

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Recommended Citation

Thanos, Lori M. (2015) "Tyco International Ltd. Case Study: The Implications of Unethical Behavior," *Academic Leadership Journal in Student Research*: Vol. 3 , Article 7.
Available at: <https://scholars.fhsu.edu/aljsr/vol3/iss1/7>

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Tyco International Ltd. Case Study: The Implications of Unethical Behavior

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Abstract

The following analysis of the Tyco International Ltd. (Tyco) case will discuss an historical summary of Tyco, including a backdrop on its former CEO, Dennis Kozlowski and Tyco's culture at the time. The case will also define the role of ethical leadership's contribution to the organizational success and the unethical and illegal conduct of Tyco's leaders including the costs to its internal and external stakeholders, such as gross misappropriation of company funds on personal expenditures and duplicitous stock sales.

Additionally, the case study will describe the importance of corporate social responsibility (CSR) to the organization, specifically, how Tyco failed to meet its CSR obligations. It also depicts the consequences to stakeholders with regard to cultural, environmental, and legal implications of CSR failures. Further, an examination is made of the outcome and punishment of events including the fairness of those punishments. Finally, the study will propose recommendations for ethical behavior with regard to corporate actions and organizational sustainability.

Introduction

Adhering to ethical business standards and practices is a necessary part of business sustainability in today's market (Alleyne and Amaria, 2013). It bodes well for companies to exhibit stellar leadership tenets and virtues throughout their entire organization in an effort to achieve those standards. Eisenbeiss (2012) defines ethics, originally derived from the Greek word *ethos*, meaning traditions, behaviors, or character, as exhibiting values and morals, which individuals or society deems proper or appropriate. Famous management theorist, Peter Drucker (as cited in Cohen, 2009), claims there is no replacement for ethical leadership when endeavoring to achieve organizational success. It is clear from its downfall that Tyco's leaders fell significantly short of this standard.

Moreover, an organization's sustainability, in large part, rests on its ability to foster CSR (Aggarwal, 2011). As such, an integral part of a firm's CSR role is to actively make efforts toward supporting the rights of all of its stakeholders including employees, the government, the public, and its shareholders, if it is a public company. In the Tyco case, it is evident that its senior executives were less than mindful, even illegal, in its actions with regard to all of its stakeholders, resulting in an unfavorable end for all parties involved.

Historical Summary of Tyco

In 1960, Tyco International Ltd., located in Waltham, Massachusetts, began as an investment and holding company with a growing concentration in solid-state science and energy conversion (Giroux, 2008). It later diversified into a global

conglomerate company through fierce and rapid acquisitions providing products and services in four business segments: fire and security, electronics, engineering goods and services, and healthcare (Giroux, 2008). Within four years, 1997 to 2001, Tyco acquired 750 companies and revenues rose by 50 percent from the \$6 billion acquisition of ADT Security Services (Daniels Fund, n.d.). Tyco depended heavily on a growth strategy which focused on extreme acquisition, and by the early 2000s, it had owned more than thirty major companies, including the CIT Group, the largest independent commercial financial company in the U.S., for \$9.2 billion, which ended up a failed venture (Giroux, 2008). In 1964, Tyco went public and began to rapidly acquire many other companies expanding from \$34 to \$500 million in consolidated sales (Daniels Fund, n.d.). According to Kay (2002), it had 240,000 employees at the time of the scandal, and many of those employees were affected gravely either by termination and/or losses in their pension funds. Tyco's reputation was marred with the knowledge that its executives in their top lines of management were unprincipled and deceitful (Kay, 2002).

Dennis Kozlowski, Former Tyco CEO

In 1975, Dennis Kozlowski, former Tyco CEO, joined the company under Joseph Gaziano, the preceding CEO of Tyco (Daniels Fund, n.d.). Kozlowski started as an accountant and eventually became the President of Grinnell Fire Protection Systems, Tyco's largest division at the time. Gaziano had an excessive lifestyle, courtesy of Tyco funds, such as company jets, expensive vacations and fancy club memberships, and Kozlowski, dazzled by this glamour, began to mimic this lifestyle (Daniels Fund, n.d.). However, in 1982, John F. Fort III replaced Gaziano, and Fort's management style and spending habits were intensely different than Gaziano's style (Daniels Fund, n.d.). Kozlowski had to quickly adjust to the company's new focus of vigorously increasing stockholder profitability while curtailing the lavish spending habits he had grown accustomed to (Daniels Fund, n.d.).

Shortly after Kozlowski became the President of Grinnell Fire Protection Systems, he became President and CFO of Tyco (Daniels Fund (n.d.). Fort, troubled by Kozlowski's acquisition pattern of speed and aggression, appealed to the Board of Directors to restrain Kozlowski's activities, particularly after Tyco's acquisition of Wormald International, a \$360 million global fire protection firm (Daniels Fund, n.d.). However, the Board of Directors sided with Kozlowski; thus, Fort resigned as CEO in 1992, and Kozlowski took over as CEO, resuming his former lifestyle including owning several extremely expensive houses, incessant reveling, and an extremely aggressive management style (Daniels Fund, n.d.). This was the beginning of a long chain of unethical and illegal conduct.

Tyco Culture

An organization's culture often impacts the success of achieving the common organizational goal of increasing shareholder profitability (Vanourek and Vanourek, 2013). Frequently, the pressure put on company executives is without regard to how they will meet these expectations, and only results matter. There is an expectation by company stakeholders that financial executives exhibit leader stewardship and behave ethically beyond achieving the goal of operational sustainability and profit maximization (Vanourek and Vanourek, 2013). They should do so even if it costly and difficult to do. According to Daniels Fund (n.d.), Kozlowski humiliated those who failed to meet his high profit expectations and rewarded those who achieved his inflated financial goals regardless of the means. The events during Kozlowski's reign reveal that the Tyco culture did not display leader stewardship nor did it engender a spirit of organizational trust.

Tyco Scandal Examined

The Tyco scandal of 2002 clearly demonstrates that the firm's moral compass was askew. In the restructure of Tyco, Kozlowski compromised the company's corporate governance system in positioning his close associates in prominent organizational ranks, thus leaving room for his cohorts to assist and participate in his wrong doing (Brickey, 2008). Kozlowski and some other executives were able to perpetrate crimes of fraud, grand larceny and conspiracy, embezzlement, accounting conflicts of interest, excessive unethical personal spending and other questionable activities, since Tyco was left unprotected by its damaged controls (Kay, 2002). Authorities accused Kozlowski and Swartz, Tyco's CFO, of stealing \$170 million from Tyco and fraudulently selling an additional \$430 million in stock options in 2002 (Brickey, 2008). Federal prosecutors cited some of Tyco's board members, and Kozlowski, for accounting conflict of interest and pilfering of Tyco funds for luxurious private spending (Brickey, 2008). According to Insead Knowledge (2012), at the height of the scandal, Kozlowski threw his wife a \$2 million dollar birthday party on the Italian island of Sardinia, toga style, with famous singer Jimmy Buffett as the featured entertainment all courtesy of Tyco.

Authorities further investigated Tyco's board members and executives after Kozlowski's arrest, uncovering that the relationships between Kozlowski and numerous other members was questionable and fostered a tempting situation for them to engage in unethical activities (Daniels Fund, n.d.). This compromised the corporate governance system making it possible for illegal activities to occur. For instance, one board member used \$2.5 million in Tyco funds to buy his home and another received \$20 million for helping to arrange the acquisition of CIT Group without the other board members' knowledge (Daniels Fund, n.d.).

Ethical Standards and Organizational Leadership Influence

If an organization hopes to develop a positive reputation with its stakeholders and attract investors, customers, and quality management, its executives must be ethical (Stevens, 2013). Unethical leader behavior leads to lawsuits, market share deterioration, and often prison time for the leaders (Radcliffe, 2006). The Tyco case impresses upon us that poor ethical judgment and lack of integrity are dangerous liabilities with high consequences such as reputational loss and damage to vital relationships with stakeholders. Kozlowski's unethical conduct severely damaged Tyco's reputation, and the public viewed it as a very disreputable organization for years after the scandal (Kay, 2002).

Schaubroeck, et al. (2012), comment that organizations that want to create an ethical environment and foster ethical standards must promote ethical stewardship from its leaders. Many organizations are developing formal codes of ethics in response to filling their role as ethical stewards (Vanourek and Vanourek, 2013). Leaders must earn the trust of their followers by being accountable for their actions and honoring their commitments, thus creating the conduit for employees to accept leaders as their stewards (Caldwell, Hayes, and Long, 2010).

The spirit of organizational leadership is influencing and motivating employees toward achieving organizational objectives and increasing profits and sustainability of an organization (Yukl, 2012). Organizational leaders have three vital responsibilities they must assume: cultivating strong bonds with employees, motivating stakeholders to maintain organizational loyalty, and recognizing desirable company results then monitoring and improving those results (Caldwell, Hayes, and Long, 2010). Accomplishing these goals requires leaders to follow ethical principles, exhibit honesty and trustworthiness, by speaking the truth in all matters, and not avoid obligations and accountability (Yidong and XinXin, 2013).

Finally, ethical leaders create an atmosphere of community in their organization and build a spirit of trust where employees feel loyalty toward the organization and its leadership (Karakas and Sarigollu, 2013). Organizations must be concerned with all the members of its organizational community, the culture which is permeating the firm, and the integrity of its leaders (Sarwar, 2013). An employee's level of organization trust greatly affects the organization's leadership influence over the employee; conversely, an employee's organization distrust causes productivity decreases, waning loyalty, and lost time and money (Caldwell, Hayes, and Long, 2010).

Tyco Leadership

The success in recognizing, eradicating, and inhibiting unethical corporate behavior, often lies in the strength of an organization's culture and internal controls (Alleyne and Amaria, 2013). The type of leadership displayed and examples shown by its senior management can thus lead an organization to higher moral ground and a sense of trust rather than fear (Eisenbeiss, 2012). Daniels Fund (n.d.), indicates that Kozlowski's leadership was unethical and without regard for its employees and other stakeholders. His unethical and illegal actions did little to gain trust from his employees or other stakeholders and caused the company great financial harm. Ethical leaders need to be prepared to defend their actions based on solid values and ethical principles (Freeman and Stewart, 2006). When questioned, Kozlowski and Swartz, were unable to defend their actions of excessive spending with any reasonability claiming only that they had exercised poor judgment; nothing they did was hidden (Neal, 2013). What reason could Kozlowski give for the purchase of a \$6,000 shower curtain for his personal home and spending \$2 million dollars on his wife's birthday party, disguised as a shareholder meeting (Neal, 2013)?

Additionally, Kozlowski and other board members had defrauded and misled investors by keeping stock prices artificially inflated, not adding any lasting value to the organization for their stakeholders (Daniels Fund, n.d.). This form of extremism does not constitute ethical or sound judgment and decision making by Tyco's executives (Freeman and Stewart, 2006).

Finally, ethical leaders must be role models for the organization, take seriously the rights and claims of others, and consider the effects of their actions on others (Freeman and Stewart, 2006). The events of the Tyco case, including the incredible amount of personal spending by Kozlowski and other executives, the deceitful presentation of financials to investors, and the lies and deniability of their actions clearly depict an organization fraught with unethical leaders as role models.

Corporate Social Responsibility

Corporate Social Responsibility signifies one of the most advanced progressions in today's business environment. The World Business Council for Sustainable Development offers the most worldwide definition of CSR: "it is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large" (Virvilaite and Daubaraitė, 2011, p. 535). Given the numerous and mounting corporate scandals, financial crisis, and environmental threats, society is increasingly expecting corporations to behave ethically and socially responsible (Mason and Simmons, 2014). Moreover, according to Cohen (2009), it is no longer acceptable to limit business responsibilities to profit making only; a firm must actively care for the interests of all of its stakeholders, including its employees, customers, the government, the local community, and stockholders, if the company is public. Employees should be valued as assets or resources to an organization, not costs, thus, assuming its obligation to look after its employee's best interests (Cohen, 2009). Moreover, a company should protect and support the local community's best interests as it is one of the firm's most indispensable resources.

Mason and Simmons (2014), support that a company's board of directors should protect the key interests of stakeholders as part of fulfilling its CSR role. It defines and implements corporate strategy and, as the company's corporate governance system, should serve to safeguard the interests of key beneficiaries (Mason and Simmons, 2014). Kozlowski's reign at Tyco depicted the complete opposite of this expectation. Tyco's leaders, particularly Kozlowski and Swartz, had little, if any, regard for its stakeholders as seen by the incredulous, excessive, unethical spending of the stakeholder's money on personal pursuits. As a direct result of this unethical and illegal conduct, many employees lost their pensions (Daniels Fund, n.d.). That can hardly be categorized as improving the quality of life of employees and their families as stated in Virvilaite and Daubaraitė (2011). Neither the outrageous spending of company earnings nor the illegal loans could be conceived as lawful disclosure to investors (Smith, 2002).

Outcome of Events

The Securities and Exchange Commission (SEC) investigated Tyco's financials in 1999 when the company restated its earnings causing suspicion (Giroux, 2008). In 2002, The Manhattan district attorney accused Kozlowski of massive sales tax evasion which prompted a further investigation into Tyco's illegal activities (Kaplan, 2009). For example, Tyco had forgiven a \$19 million interest free loan to Kozlowski, even paying his income taxes on the loan. The company's stock price resulted in an overvaluation due to these insidious events (Joyner and Raiborn, 2005). Kozlowski and Swartz had sold 100 million dollars' worth of shares and then declared to the public that they had kept the stock which was misleading and a misrepresentation to its investors (Smith, 2002). Moreover, it is common practice to benchmark portfolio performance and question those results when unusually higher or lower than industry standards (Wong, Leung, and Gilleard, 2013). These radically high results should have raised suspicion by the investors and led them to make serious inquiry as to how Tyco was achieving those results.

Does the Punishment Fit the Crime?

The fairness of Kozlowski's punishment, a jail sentence of 8 to 25 years for his unethical and illegal activities during his reign at Tyco, have been subject to debate. Kozlowski stated with conviction that his actions were not criminal but merely bad judgment, and he did not believe he deserved the sentence he received (Kaplan, 2009). However, Kozlowski and cohorts had full knowledge that their actions were defrauding Tyco's investors causing Tyco's stock to collapse and causing a rippling effect to the broader market (See Chart 1 below) (Kaplan, 2009; Interactive Data Corp., n.d.). Further, countless people lost colossal amounts of funds from holding this security in their retirement accounts (Daniels Fund, n.d.). It is likely that if Kozlowski had continued in his crooked course uninterrupted, then Tyco would have had the same end as did other debauched companies during that time period, such as Enron and WorldCom (Kaplan, 2009). The punishment exacted upon Kozlowski and other executives at Tyco appropriately reflected their unrepentant illegal acts.

Chart 1.

Tyco International Stock vs. S&P Years: 2005 to 2014



(Stockchart.com, n.d.)

Is greed really a punishable offense by law? No, it is not. However, as Daniels Fund (n.d.) comments, Tyco executives knew full well that their acts of greed were substantive of fraud against its stakeholders in the form of theft of company funds, accounting conflicts of interest, bribery, and inappropriate employee discharges. Based on the intentions of Kozłowski and his cohorts to mislead and defraud Tyco stakeholders, the punishment levied against them was fair. Corporate executives have a responsibility as leadership and financial stewards, and that responsibility holds executives accountable for their actions as well as their intentions toward their stakeholders (Vanourek and Vanourek, 2013). The crimes perpetrated by Kozłowski and company went beyond greed; their actions were intentionally deceitful against those whom they were specifically charged to protect, namely Tyco stakeholders.

Action Recommendations

According to Smit (2013), business sustainability is in jeopardy from the lack of ethical management; business professionals must evaluate the role of management education in the areas of ethical and functional standards and incorporate the development of responsible leadership. As such, the author recommends that organizations establish and enforce codes of ethics, including management training of those codes, regular performance measurement against those codes through standardized metrics, and full support and by example from senior management.

Summary

Tyco incurred great damage during the scandal of 2002 due to the lack of a strong ethical environment coupled with the absence of top executive ethical leadership stewards. If an organization expects to survive and thrive in today's business environment, it must be more than mindful or conscious of ethical standards; it must be active in incorporating those standards along with strict proper internal controls to restrict unethical and/or illegal actions. A company must protect its corporate governance system from dubious penetration of unethical conduct. Tyco executives committed crimes of embezzlement, dishonesty, and accounting fraud in the absence of such controls. Furthermore, these actions not only impacted the company's employees and shareholders, but had an undulating effect on those who held Tyco stock in their 401Ks, thereby, in some cases, postponing their retirement. It is incumbent upon those in a position of caretaking to behave in the best interests of those in its employ as well as the many other stakeholders to whom they are responsible.

The dominant culture in an organization must be that of trust, a factor that was sorely missing during the Tyco scandal. It is the obligation of a company's management to instill in its employees the need to behave ethically in both their professional and personal relationships, and beyond that, to behave ethically themselves (Caldwell, Hayes, and Long, 2010). The formation of a stronger, lasting bond between an organization and its stakeholders, will contribute to the company succeeding in achieving higher profit maximization (Cohen, 2009). An important factor in molding the ethical conscience business executives relies on the training they receive from their organizations. A question worth pondering is just how much ethical training did Kozłowski and his associates receive from the Tyco organization?

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