Turning around Tyco: how corporate governance saved the day

By Shellie Karabell

“Shareholders are screaming. The stock price has dropped from $60 to $7 a share. The press is hitting you every day with requests for info on the turnaround of the company. The prior management is still there, wondering about their futures. The prior board is there, wondering about their futures. And you’re there, trying to bring some order to this chaos.”

That’s how Eric Pillmore describes a typical day at the office when he stepped into the corporate governance role at Tyco early in August of 2002. The company’s CEO Dennis Kozlowski and CFO Mark Swartz had been convicted in June for theft and fraud involving more than $600 million from the company in the form of unauthorised stock trades and unapproved personal loans from the firm, which were subsequently written off.

Tyco had boasted stellar performances under Kozlowski’s leadership, increasing its generation of cash to five billion dollars in 2004 from 600 million within two years – largely through acquisitions which strengthened the company's five core businesses. Kozlowski himself had been a long-time Tyco employee, starting in 1976 as an internal auditor, working his way up to CEO.

"He (Kozlowski) did a great job of building a set of core businesses that are very healthy today and were very healthy then," confirms Pillmore (one of Kozlowski's acquisitions, ADT, is today the cornerstone of Tyco's security business). "He grew up in the company … then, I believe, he thought he was part of the company and that the assets of the company were also his. There was clearly a mixing of what he thought were his personal funds and what he believed to be the company's funds. He saw them as one."

Kozlowski's practices were the subject of some external and internal auditing at Tyco long before he was arrested … but the fraud fell between the two investigations. "The scope of the internal audits never included the headquarters function," says Pillmore. "The actual function at the holding company is where the fraud occurred. These transactions were booked at the level below what the external auditors checked, and internal auditors were not involved in reviewing headquarters functions."

The tenor of the times only exacerbated Tyco's precarious position. Sarbanes-Oxley (the full-disclosure law passed in the US and used internationally as a transparency benchmark for vested interests) was working its way through Congress; corporate governance was a hot issue, Enron and WorldCom had fallen. Public cynicism towards corporate greed was increasing.

In this climate of distaste and distrust, Pillmore carved out his governance strategy for Tyco. "One of the first things we did was establish guidelines from a value standpoint. That, along with delegation of authority from a governance standpoint were foundational to whatever else we were going to do," he says. "Then we had this huge communication effort to try to calm the storm." That involved sending out the corporate message to Tyco's 240,000 employees in 100 different countries in 16 major languages – videos, print materials, town meetings, in-person visits.

Then came the turnaround at the board and top management levels. "Ed Breen (the man brought in to take over the CEO position at Tyco) asked this question of each board member when he interviewed for the job: 'Will you be willing to resign should the company have to go in that direction, where the entire board has to step down?' And to a person they said 'Yes.' So when it came time to do that, we were able to do that. The second challenge was recruiting a whole new team of 12 talented folks whom investors could believe could lead this company through these challenging times.”

All this at a time when Tyco was trying to generate enough cash to balance its books. “In terms of the cost (of the turnaround), it was in the billions of dollars. The shareholder lawsuit alone was a $2.5 billion liability.”

It is difficult for the outsider to imagine that a fraud of this magnitude would have gone unsuspected, if not undetected, within the company. “This is one scandal that really didn’t have a whistle-blower,” says Pillmore. “I think the tone set by the then-CEO (Kozlowski) created a very intimidating culture where people were very unwilling to speak up.”

Today, retired from Tyco, Pillmore runs his own consulting firm and preaches the corporate governance gospel, focusing on three big lessons to CEOs. “The first thing is to look at your own organisation and make sure there’s a healthy amount of mentoring going on, particularly in the accountability functions – finance, HR, legal, etc.,” says Pillmore.

“The second thing is the idea of building accountability around yourself as a leader. That is, you have to have some people around you who can hold you accountable; should you be tempted to start to go in the wrong direction, you need to have people around you who are willing to push back and challenge you. And then last but not least is this whole idea of character. Evaluating character in the people you hire, the character of the leadership team, monitoring that team for such things as integrity,” he adds. “Am I going to be able to raise my hand in a meeting when I see the board going in the wrong direction? Am I brave enough to speak up?”

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