Strathmore
UNIVERSITY

SCHOOL OF HUMANITIES & SOCIAL SCIENCES

BACHELOR OF ARTS IN COMMUNICATION

END OF SEMESTER EXAMINATIONS

BAC 4104: ISSUES AND CRISIS MANAGEMENT

Date: Friday 25th October 2019 **Time: 13:00 – 15:00**

Instructions

Question **one** is compulsory. Answer **two** other questions. This will make a total of three questions.

QUESTION ONE (30 marks)

WorldCom faces a world-record bankruptcy and leadership scandal

Bernie Ebbers Builds a Network

Ebbers was a charismatic CEO, known for his personal Christian faith and charity work. Born in Edmonton, Canada, he was raised in New Mexico where his father was a business manager for a Christian mission. Reports say Ebbers flunked out of the University of Alberta and Calvin College before enrolling at Mississippi College, where Ebbers said his life changed. He graduated in 1967 and went to work as a teacher and coach in a small town south of Mississippi's capital, Jackson. He then founded a small chain of hotels, working with two friends who later sat on the WorldCom board.

In 1983, he and several other businessmen took advantage of the AT&T telephone breakup and started a company that would resell bandwidth, the data-carrying capacity of telephone lines, to small businesses. Sensing an opportunity, he bought 75 companies in the next 15 years.

He took his company, Long Distance Discount Service, public in 1989. It was reported that Ebbers boasted that LDDS never grew at less than 16%. He encouraged employees to buy stock options, a practice that would continue throughout his career. His practice of offering large personal loans to key employees in order for them to buy stock was well known. He also became known as not being involved in the actual operations of the telecommunication industry, but intensely interested in the possibilities for mergers and acquisitions within it.

In the early 1990s, Ebbers began to buy companies that owned fiber-optic lines so that he could move data on his own lines. In August 1994, he bought Wiltel, a Tulsa, Oklahoma, company that owned the fourth-largest fiber network in the United States, and renamed it WorldCom. That enabled him to take advantage of the burst of interest in the Internet during the mid-1990s. By 1997, WorldCom owned 20% of the Internet fiber network, and the corporation grew like wildfire.

The stock value attracted investors who put all their funds in the one stock. On June 21,1999, WorldCom stock reached a high of $64.50 per share, and Ebbers was listed by *Forbes* as among the richest men in the world, ranking his personal fortune at some $1.4 billion. Ebbers reportedly enjoyed his wealth. He paid $47 million to buy the largest working ranch in Canada, a half-million acre spread with cattle, a fishing village, and a heavy-equipment dealership.

In 1997, Ebbers made his boldest move, buying MCI's residential and long-distance telephone service for $37 billion. Yet, he sold off its Internet network when faced with federal regulators' protests about fears of limiting fiber-optic competition. A 1999 attempt to merge with Sprint was blocked by American and European regulators.

At the same time, growth in the Internet dropped by 90%. Stock values dropped. Ebbers' fortune also dropped; he was forced to sell 3 million shares of his WorldCom stock in October 2000 to raise $84 million to pay off investment debts. Ebbers prepared to sell more shares in January 2002.

The WorldCom board, afraid that such a sale would drop the stock value even further below the $9.80 it was then valued at, loaned Ebbers more than $400 million at 2.2% interest. Reaction to this arrangement created outrage among other investors who had seen their share values drop precipitously. In March, the SEC requested information related to WorldCom accounting procedures and loans to officers. Ebbers resigned in April, taking with him a $1.5-million-a-year pension.

Investigation Reveals a Tangled Network of Accounting
That might have ended the story, had not an investigation revealed other problems. Reports in June 2002 documented that the company had designated $3.8 billion as assets instead of expenses to cover a net loss for 2001 and the first quarter of 2002, and chief financial officer (CFO) Scott Sullivan was fired.

Following an internal audit, WorldCom admitted inflating earnings over a period dating back to 1999. For example, it claimed that the costs of leasing telephone lines from other companies were capital investments. It would later argue in court that its internal accounting records were so confused that it was impossible to verify or balance them. (Subsequently, the SEC asserted the improper bookkeeping had totaled more than $9 billion.) The corporation began laying off thousands of employees in June 2002.

The new CEO, John Sidgmore, held a press conference in Washington to apologize for the accounting scandal. He said the company hoped to avoid bankruptcy. However, WorldCom filed for Chapter 11 bankruptcy July 21,2002, listing $103.9 billion in assets. The corporation owed $67 billion to its creditors. Shares traded at less than $1 by the end of that year. Sidgmore resigned as CEO in September.

Two corporate officers, including CFO Scott Sullivan, were charged in August 2002 by federal officials with securities fraud and filing false statements with the SEC. In September, the corporation's former controller pleaded guilty to three counts of conspiracy, securities fraud, and making false statements to the SEC. The next month, the former accounting director pleaded guilty to two counts of securities fraud and conspiracy.

Rebuilding a Network for Leadership
In November, WorldCom reached a settlement with the SEC. In December, federal judges approved the hiring of new CEO Michael Cappellas, former Hewlett-Packard president. The board of directors was also reformed after six directors resigned.

The board had included the former head of the National Association of Securities Dealers, the chairman of Moody's Investors Service, and the dean of the Georgetown University Law Center, along with several company chief executives.

A report compiled by a committee of new directors said the previous board had been given information that "was both false and plausible." The board had met infrequently, sometimes only 3 to 5 hours a year. Its operations changed dramatically after the reorganization.

New CEO Capellas told the *Washington Post,* "The company has already implemented many of the proposed corporate reforms, but we know we have to do even more to regain public trust."

The *Washington Post* described how the new board considered buying remaining shares of Digex Inc. It had been given a detailed report from its investment

bankers and a presentation from the corporate development team, and the Digex chairman was available to answer questions. The directors then met privately to discuss the $18 million purchase.

The *Post* said the last time WorldCom had considered a deal to buy the corporate "parent" of Digex, Intermedia Communications, the board approved the $6 billion acquisition after only 35 minutes of discussion. Board members had been given no written material to review, and some were not told that such an acquisition was due for a vote until 2 hours before a convened conference call. The federal monitor,

Richard C. Breedon, a former SEC chairman, required the new board to meet at least 10 times a year and to replace at least one member every 12 months. No director would be allowed to remain on the board more than 10 years. With the exception of the CEO, directors were required to have no outside ties to the company.

Pay for directors was boosted to $150,000 a year, but they were required to take at least 25% of the salary in stock. Stock options would not be granted to employees and board members. Instead, they would be granted restricted company shares with rules limiting when they could be sold. The cost of the stock grants would be included in profit-and-loss statements.

The reformed corporation took out a full-page advertisement in leading U.S. newspapers in December 2002 to offer what it called a "Summary of Progress." The ads' headline proclaimed, "WorldCom Wants You To Know: From governance to finances, quality of service to customer commitment, we've made signify cant progress. And we're just beginning."

It touted the hiring of a new CEO and new independent board members, the generation of more than $1 billion in cash and available financing, the meeting of service benchmarks, and its ability to retain customers and to attract new ones. More information, the ad said, would be available on the corporate Web site at www.worldcom.com/update.

By April 2003, WorldCom announced a reorganization plan to erase most of its debt and to rename itself after its long-distance unit, MCI. Headquarters for the corporation would be moved to Ashburn, Virginia. The corporation agreed to pay investors $500 million to settle civil fraud charges and a $750 million settlement with federal regulators.

According to the *Washington Post,* the corporation emerged from bankruptcy with $4.6 billion in cash. In August 2003, Ebbers was arraigned and charged by the state of Oklahoma on 15 fraud counts. He pleaded innocent to the charges. Four other executives were charged by the state. Federal investigations continued.

Source: Lamb, L. F., & McKee, K.B., (2005) . Applied Public Relations : Cases in Stakeholder Management. Lawrence Erlbaum: New Jersey

QUESTION ONE

a) Please explain how the following concepts using illustrations from this case.

   i. Incident
   ii. Crisis
   iii. Issues
   iv. Risk communication

(12 marks)

b) Briefly discuss why **accountability** and **trust** are important in a crisis cycle. Use examples from this case. **(6 marks)**

c) "…In March, the SEC requested information related to WorldCom accounting procedures and loans to officers. Ebbers resigned in April, taking with him a $1.5-million-a-year pension."

   Supposing you were the PR manager for WorldCom during this period, prepare a holding statement for sharing to the media. **(8 marks).**

d) Briefly evaluate the post crisis phase as manifested in this case. **(4 marks)**

QUESTION TWO

a) Explain three key skills for Public Relations Professionals that will enable them effectively handle crises. **(6 marks)**
b) Describe how Public Relations practitioners can analyse issues, using an impact-influence matrix. **(9 marks**)

QUESTION THREE

a) Explain how organisations may minimise drama, conflict and suffering during a crisis, as a media management strategy. **(6 marks)**
b) Evaluate the effectiveness of the image repair theory against the contingency theory.**(9 marks)**

QUESTION FOUR

a) Discuss how a crisis history of an organization, and its relationship with stakeholders may influence the outcome of a crisis. **(6 marks)**
b) Explain at least three elements of political communication. **(9 marks)**

QUESTION FIVE

a) Explain three challenges public relations practitioners face in a social media crisis. **(6 marks)**

b) Evaluate the effectiveness of any **three** of the following crisis communication strategies:
   a) Denial
   b) Bolstering
   c) Differentiation
   d) Mortification

   (9 marks)