WorldCom: at the heart of the crisis
Joan Fontrodona, IESE Professor

Having admitted to falsifying results, WorldCom has added its name to a list, which is getting rather long, of companies that have resorted to accounting stratagems to massage their accounts. Many of the cases involve telecommunications companies. Is this a sector prone to such practices? This may be so, but it is, however, due to the present situation and the particular characteristics of this crisis.
The origin of the present economic crisis must be sought in the boom of the New Economy and the technological share prices at the end of the nineties. Back then it was said that the best placed companies were not only the dotcoms but also all the enterprises working around the Internet: content providers, software manufacturers or communications companies. So the telecommunications operators were riding the crest of the wave or in the eye of the hurricane, depending on your point of view.
On the other hand, their products were quite appropriate for the age when the markets became truly international. The Law of Metcalfe, which says that the value of a network increases exponentially with the number of users, perfectly applies to the world of telecommunications.
However, their core position in the new market made them prone to lead vertical integration processes. The WorldCom case is paradigmatic. Since 1992 it had started a policy of acquisitions and mergers with other companies, among which was MCI in 1998 for almost 40,000 million dollars, which at the time was the biggest merger ever made.
The financial operations came with the spectacular appointments of executives, whose very names seemed to guarantee a promising future for the company. Let us not forget that this sector was one of the most notable for its polemics about the policies of remuneration and the famous stock options. At the time it was pointed out that these practices could lead to an excessively centred vision of results in the short term and the closure of operations that would have a strong reaction on the stock markets, independent of their feasibility or strategic coherence.
The huge investments that these operations brought about affected the financial stability of the companies in the sector and left them in a very weak position in the event of a possible slowdown of the market, which is exactly what happened later. It is well known that when there is an earthquake the worst affected areas are those nearest the epicentre. The telecommunications companies were at the centre and up to a point it is logical that they are the ones that should take the brunt of the damage. However, they must not be seen entirely as victims, because in this case more than victims as such, they are responsible for the crisis of confidence the financial markets are going through, due to a lack of ethics in some of their actions.