



The Biggest Stock Scams Of All Time

by Investopedia Staff, (Investopedia.com) ([Contact Author](#) | [Biography](#))

It is unfortunate, but words often associated with money and fortune are "cheat," "steal," and "lie." Who among us hasn't "accidentally" taken two \$500 bills from the Monopoly bank, or forgotten at least once to pay \$5 back to a friend? Chances are you were never called on it because your friends trusted you. Just as we trust our friends, we put faith in the investing world. Investing in a stock takes a lot of research, but it also requires us to make a lot of assumptions. For example, we assume reported [earnings](#) and [revenue](#) figures are correct, and that management is competent and honest. But these assumptions can be disastrous.

IN PICTURES: [Stock Scams Slideshow](#)

Understanding how disasters happened in the past can help investors avoid them in the future. With that in mind, we'll look at some of the all-time greatest cases of companies betraying their investors. Some of these cases are truly amazing; try to look at them from a shareholder's standpoint. Unfortunately, these shareholders had no way of knowing what was really happening as they were being tricked into investing.

- **ZZZZ Best Inc., 1986** - Barry Minkow, the owner of this business, posited that this carpet cleaning company of the 1980s would become the "General Motors of carpet cleaning". Minkow appeared to be building a multi-million dollar [corporation](#), but he did so through forgery and theft. He created more than 10,000 phony documents and sales receipts without anybody suspecting anything. Although his business was a complete fraud designed to deceive auditors and investors, Minkow shelled out more than \$4 million to lease and renovate an office building in San Diego. ZZZZ Best went [public](#) in December of 1986, eventually reaching a [market capitalization](#) of more than \$200 million. Amazingly, Barry Minkow was only a teenager at the time! He was sentenced to 25 years in prison.
- **Centennial Technologies Inc., 1996** - In December 1996, Emanuel Pinez, the CEO of Centennial Technologies, and his management recorded that the company made \$2 million in revenue from PC memory cards - the company was really shipping fruit baskets to customers. But the employees then created fake documents to appear as though they were recording sales. Centennial's stock rose 451% to \$55.50 per share on the [New York Stock Exchange](#) (NYSE). According to the [Securities and Exchange Commission](#) (SEC), between April 1994 and December 1996, Centennial overstated its earnings by about \$40 million. Amazingly, the company reported profits of \$12 million when it really lost about \$28 million! The stock plunged to less than \$3. Over 20,000 investors lost almost all of their investment in a company that was once considered a Wall Street darling.

- **Bre-X Minerals, 1997** - This Canadian company was involved in one of the largest stock swindles in history. Its Indonesian gold property, which was reported to contain more than 200 million ounces, was said to be the richest gold mine ever. The stock price for Bre-X skyrocketed to a high of \$280 ([split adjusted](#)), making millionaires out of ordinary people overnight. At its peak, Bre-X had a market capitalization of US\$4.4 billion. But the party ended on March 19, 1997, when the gold mine proved to be fraudulent, and the stock tumbled to pennies shortly after. The major losers were the Quebec public sector pension fund, which lost \$70 million; the Ontario Teachers' Pension Plan, which lost \$100 million and the Ontario Municipal Employees' Retirement Board, which lost \$45 million.
- **Enron, 2001** – Prior to this debacle, [Enron](#), a Houston-based energy trading company was, based on revenue, the seventh largest company in the U.S. Through some fairly complicated accounting practices that involved the use of [shell companies](#), Enron was able to keep hundreds of millions worth of debt off its books. Doing so fooled investors and [analysts](#) into thinking this company was more fundamentally stable than it actually was. Additionally, the shell companies, run by Enron executives, recorded fictitious revenues, essentially recording one dollar of revenue multiple times, thus creating the appearance of incredible earnings figures. Eventually, the complex web of deceit unraveled, and the share price dove from over \$90 to less than \$0.70. As Enron fell, it took down with it Arthur Andersen, the fifth leading accounting firm in the world at the time. Andersen, Enron's auditor, basically imploded after David Duncan, Enron's chief auditor, ordered the shredding of thousands of documents. The fiasco at Enron made the phrase "[cook the books](#)" a household term once again.
- **WorldCom, 2002** - Not long after the collapse of Enron, the equities market was rocked by another billion-dollar accounting scandal. Telecommunications giant [WorldCom](#) came under intense scrutiny after yet another instance of some serious "book cooking". WorldCom recorded [operating expenses](#) as [investments](#). Apparently, the company felt that office pens, pencils and paper were an investment in the future of the company and therefore expensed (or capitalized) the cost of these items over a number of years. In total \$3.8 billion (yes, with a 'b') worth of normal operating expenses - which should all be recorded as expenses for the fiscal year in which they were incurred - were treated as investments and were recorded over a number of years. This little accounting trick grossly exaggerated profits for the year the expenses were incurred; in 2001, WorldCom reported profits of around \$1.3 billion. In fact, its business was becoming increasingly unprofitable. Who suffered the most in this deal? The employees - tens of thousands of them lost their jobs. The next ones to feel the betrayal were the investors who had to watch the gut-wrenching downfall of WorldCom's stock price, as it plummeted from more than \$60 to less than \$0.20.
- **Tyco International (NYSE: [TYC](#)), 2002** - With WorldCom having already shaken investor confidence, the executives at Tyco ensured that 2002 would be an unforgettable year for stocks. Before the scandal, Tyco was considered a safe [blue chip](#) investment, manufacturing electronic components, healthcare and safety equipment. During his reign as CEO, Dennis Kozlowski, who was reported as one of the top 25 corporate managers by *BusinessWeek*, siphoned hordes of money from Tyco in the form of unapproved loans and fraudulent stock sales. Along with CFO Mark Swartz and CLO Mark Belnick, Kozlowski received \$170 million in low-to-no

interest loans, without shareholder approval. Kozlowski and Belnick arranged to sell 7.5 million shares of unauthorized Tyco stock for a reported \$450 million. These funds were smuggled out of the company, usually disguised as executive bonuses or benefits. Kozlowski used the funds to further his lavish lifestyle, which included handfults of houses, an infamous \$6,000 shower curtain and a \$2 million birthday party for his wife. In early 2002, the scandal slowly began to unravel and Tyco's share price plummeted nearly 80% in a six-week period. The executives escaped their first hearing due to a mistrial, but were eventually convicted and sentenced to 25 years in jail.

- **HealthSouth (NYSE: [HLS](#)), 2003** - Accounting for large corporations can be a difficult task especially when your boss instructs you to falsify earnings reports. In the late 1990s, CEO and founder Richard Scrushy began instructing employees to inflate revenues and overstate HealthSouth's [net income](#). At the time, the company was one of America's largest healthcare service providers, experiencing rapid growth and acquiring a number of other healthcare related firms. The first sign of trouble surfaced in late 2002, when Scrushy reportedly sold HealthSouth shares worth \$75 million, prior to releasing an earnings loss. An independent law firm concluded the sale was not directly related to the loss, but investors should have taken the warning. The scandal unfolded in March, 2003, when the SEC announced that HealthSouth exaggerated revenues by \$1.4 billion. The information came to light when CFO William Owens, working with the FBI, taped caught Scrushy talking about the fraud. The repercussions were swift, as the stock fell from a high of \$20 to a close of \$0.45 in a single day. Amazingly, the CEO was acquitted of 36 counts of fraud, but was later convicted on charges of bribery. Apparently, Scrushy arranged political contributions of \$500,000, allowing him to ensure a seat on the hospital regulatory board.

Conclusion

The worst thing about these scams is that you never know until it's too late. Those convicted of fraud might serve several years in prison, which in turn costs investors/taxpayers even more money. These scammers can pick a lifetime's worth of garbage and not even come close to repaying those who lost their fortunes. The SEC works hard to prevent such scams from happening, but with thousands of public companies in North America, it is nearly impossible to ensure that disaster never strikes again.

Is there a moral to this story? Sure. Always invest with care and [diversify](#), diversify, diversify. Maintaining a well-diversified [portfolio](#) will ensure that occurrences like these don't run you off the road, but instead remain mere speed bumps on your path to financial independence.

For further reading, see the [Investment Scams](#) tutorial and [Playing The Sleuth In A Scandal Stock](#).

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