Class Assignment

What is your opinion? Mr. Hall has a valid contract, and he did earn a very substantial profit for the company at which he works. But that company has been subsidized by a cash payment of $45 billion and a credit pledge of $335 billion—both of which essentially come from U.S. taxpayers, most of whom have never earned more than $50,000 a year in their lives. Should the $100 million bonus be paid to Mr. Hall this year? Assume that you are a consultant on executive compensation, and have been asked to advise members of the board of directors of Citigroup. What would you say? Remember, you should be prepared to *logically convince* the members of that board.

Case 1-4

Bernard Madoff and the Largest Financial Scam in History

On March 12, 2009, Bernard L. ("Bernie") Madoff pled guilty to an 11-count criminal indictment, admitting that he had defrauded thousands of investors of billions of dollars through a Ponzi scheme that he had operated under the shelter of his asset management firm—Madoff Investment Securities—for nearly 20 years. Federal prosecutors estimated that client losses totaled $65 billion.

A Ponzi scheme is an investment fund that pays what appear to be high and steady returns to the early investors from the monies put into the fund by subsequent contributors, not from legitimate gains. The scheme is named after Charles Ponzi, who emigrated from Italy to the United States in 1908 and then became notorious for using this technique in Boston during the early 1920s. At that time, eastern Massachusetts was heavily industrialized with textile mills, shoe factories, and machinery manufacturers, all of whom were dependent upon immigrants for much of their unskilled labor force. The existing banks and investment firms focused on what was termed "old money" and did not accept deposits from working-class families. Ponzi provided the needed alternative, and for a period of time appeared to be exceedingly successful.

Most Ponzi schemes do not last very long because continuing the returns that the fund advertises widely and pays regularly requires an ever-increasing flow of money from later investors in order to keep the circle not only going but growing. Also, as more investors talk about outstanding opportunities for steadiness and growth, and as more competitors complain that something must be wrong, the more likely it is that the scheme will come to the attention of governmental agencies. Ponzi's scheme lasted for 5 years; Madoff's for approximately 20, though his operations were so secretive that it is unclear exactly when he started using the "take funds from the late comers to pay the first comers" scheme.

Madoff founded Bernard L. Madoff Investment Securities LLC in 1960 with an initial investment of just $5,000 saved from stints as a beach lifeguard and a lawn sprinkler installer. He built his firm into a successful market maker, facilitating security trades by serving as a middleman between institutional investors. He focused on low

Note: William A. L. Rodgers, University of Michigan MBA, 2010, served as co-author of this case.