CASE 1.8
CRAZY EDDIE, INC.

n 1969, Eddie Antar, a 21-year-old high school dropout from Brooklyn, opened a onsumer electronics store with 150 square feet of floor space in New York City.[1])espite this modest beginning, Antar would eventually dominate the retail conumer electronics market in the New York City metropolitan area. By 1987, ntar's firm, Crazy Eddie, Inc., had 43 retail outlets, sales exceeding $350 million, nd outstanding stock with a collective market value of $600 million. Antar peronally realized more than $70 million from the sale of Crazy Eddie stock during is tenure as the company's chief executive.

A classic rags-to-riches story became a spectacular business failure in the late 980s when Crazy Eddie collapsed following allegations of extensive financial rrongdoing by Antar and his associates. Shortly after a hostile takeover of the ompany in November 1987, the firm's new owners discovered that Crazy ddie's inventory was overstated by more than $65 million. This inventory shortge had been concealed from the public in registration statements filed with the ecurities and Exchange Commission (SEC). Subsequent investigations by regutory authorities revealed that Eddie Antar and his subordinates had grossly verstated Crazy Eddie's reported profits throughout its existence.[2]

This case was co-authored by Carol Knapp, Visiting Associate Professor at the University of klahoma.

The facts of this case were drawn from numerous articles and SEC enforcement releases pubshed over a period of several years. *The New York Times* and *The Wall Street Journal*, in particar, closely followed the colorful saga of Crazy Eddie and its founder, Eddie Antar. One of the ore comprehensive investigative reports that documented the history of Crazy Eddie, Inc., is e following article: G. Belsky and P. Furman, "Calculated Madness: The Rise and Fall of razy Eddie Antar," *Crain's New York Business*, 5 June 1989, 21–33. That article provided much the background information regarding Eddie Antar that is included in this case.

EDDIE ANTAR: THE MAN BEHIND THE LEGEND

Eddie Antar was born into a large, closely-knit Syrian family in 1947. After drop ping out of high school at the age of 16, Antar began peddling television sets i his Brooklyn neighborhood. Within a few years, Antar and one of his cousir scraped together enough cash to open an electronics store near Coney Island. was at this tiny store that Antar acquired the nickname "Crazy Eddie." When customer attempted to leave the store empty-handed, Antar would block th store's exit, sometimes locking the door until the individual agreed to buy some thing—anything. To entice a reluctant customer to make a purchase, Antar firs determined which product the customer was considering and then lowered th price until the customer finally capitulated.

Antar became well known in his neighborhood not only for his unusual sale tactics but also for his unconventional, if not asocial, behavior. A bodybuilder an fitness fanatic, he typically came to work in his exercise togs, accompanied by menacing German shepherd. His quick temper caused repeated problems wit vendors, competitors, and subordinates. Antar's most distinctive trait was his ir ability to trust anyone outside of his large extended family. In later years, whe he needed someone to serve in an executive capacity in his company, Antar nearl always tapped a family member, although the individual seldom had the appro priate training or experience for the position. Eventually, Antar's father, siste two brothers, uncle, brother-in-law, and several cousins would assume leadershi positions with Crazy Eddie, while more than one dozen other relatives woul hold minor positions with the firm.

CRAZY EDDIE'S FORMULA FOR SUCCESS

In the early 1980s, sales in the consumer electronics industry exploded, doublin in the four-year period from 1981 to 1984 alone. As the public's demand for elec tronic products grew at an ever-increasing pace, Antar converted his Crazy Eddi stores into consumer electronics supermarkets. Antar stocked the shelves c Crazy Eddie's retail outlets with every electronic gadget he could find and wit as many different brands of those products as possible. By 1987, the company fea tured seven product lines. Following are those product lines and their percentag contributions to Crazy Eddie's 1987 sales.

Televisions	53%
Audio products and systems	15
Portable and personal electronics	10
Car stereos	5
Accessories and tapes	4
Computers and games	3
Miscellaneous items—including microwaves, air conditioners, and small appliances	10
Total	100%

Antar encouraged his salespeople to supplement each store's profits by pres suring customers to buy extended product warranties. Many, if not most, of th repair costs that Crazy Eddie paid under these warranties were recovered by th company from manufacturers that had issued factory warranties on the products

As a result, the company realized a 100 percent profit margin on much of its warranty revenue.

As his firm grew rapidly during the late 1970s and early 1980s, Antar began extracting large price concessions from his suppliers. His ability to purchase electronic products in large quantities and at cut-rate prices enabled him to become a "transhipper," or secondary supplier, of these goods to smaller consumer electronics retailers in the New York City area. Although manufacturers frowned on this practice and often threatened to stop selling to him, Antar continually increased the scale of his transhipping operation.

The most important ingredient in Antar's marketing strategy was large-scale advertising. Antar created an advertising "umbrella" over his company's principal retail market that included the densely populated area within a 150-mile radius of New York City. Antar blanketed this region with raucous, sometimes annoying, but always memorable radio and television commercials. In 1972, Antar hired a local radio personality and part-time actor known as Doctor Jerry to serve as Crazy Eddie's advertising spokesperson. Over the 15 years that the bug-eyed Doctor Jerry hawked products for Crazy Eddie, he achieved a higher "recognition quotient" among the public than Ed Koch, the longtime mayor of New York City. Doctor Jerry's series of ear-piercing television commercials that featured him screaming "Crazy Eddie—His prices are insane!" brought the company national notoriety when they were parodied by Dan Akroyd on *Saturday Night Live*.

Crazy Eddie's discounting policy served as the focal theme of the company's advertising campaigns. The company promised to refund the difference between the selling price of a product and any lower price for that same item that a customer found within 30 days of the purchase date. Despite the advertising barrage intended to convince the public that Crazy Eddie was a deep-discounter, the company's prices on most products were in line with those of its major competitors. The company's sales staff routinely diverted customers drawn to Crazy Eddie outlets by "advertised specials" to a higher quality and higher profit margin product.

CRAZY EDDIE GOES PUBLIC

In 1983, Antar decided to sell stock in Crazy Eddie to raise capital to finance his aggressive expansion program. The underwriting firm retained by Antar delayed Crazy Eddie's initial public offering (IPO) for more than one year after discovering that the company's financial records were in disarray. Among other problems uncovered by the underwriter were extensive related-party transactions, interest-free loans to employees, and speculative investments unrelated to the company's principal line of business. The underwriting firm was also disturbed to find that nearly all of the company's key executives were members of the Antar family. Certain of these individuals, including Antar's wife and mother, were receiving salaries approaching $100,000 for little or no work.

To prepare for the IPO, the underwriter encouraged Antar, Crazy Eddie's chairman of the board and president, to clean up the company's accounting records and financial affairs. The underwriter also urged Antar to hire a chief financial officer (CFO) who had experience with a public company and who was not a member of the Antar family. The underwriter warned Antar that investors would question the competence of the Crazy Eddie's executives who were his relatives. Despite the underwriter's concern, Antar hired his younger brother, Sam

E. Antar—who became known within the company as "Sam the CPA" to distir guish him from his father of the same name, to serve as Crazy Eddie's CFO.

The sale of Crazy Eddie's stock to the public was a tremendous success. Be cause the IPO was oversubscribed, the company's underwriter obtained permis sion from the SEC to sell 200,000 more shares than originally planned. Followin the public offering, Antar worked hard to convince the investment communit particularly financial analysts, that his firm was financially strong and well mar aged. At every opportunity, Antar painted a picture of continued growth and ir creased market share for Crazy Eddie.

One tactic Antar used to convince financial analysts that the company had rosy future was to invite them to a store and demonstrate in person his uncann ability to "close" sales. Such tactics worked to perfection as analysts from th most prominent investment firms released glowing reports regarding Craz Eddie's management team and the company's bright prospects. One analys wrote, "Crazy Eddie is a disciplined, competently organized firm with a sophis ticated management and a well-trained, dedicated staff."[3] Another analyst wrot that Antar is a "brilliant merchant surrounded by a deeply dedicated organiza tion eager to create an important retail business."[4] Because of such reports an continued strong operating results, as reflected by the company's 1984–1987 f nancial statements shown in Exhibits 1 and 2, the price of Crazy Eddie's stoc skyrocketed. Many investors who purchased the company's stock in the IPO re alized a 1,000 percent increase in the value of their investments.

CRAZY EDDIE GOES . . . BUST

Despite Crazy Eddie's impressive operating results during the mid-1980s an the fact that the company's stock was one of the hottest investments on Wa Street, all was not well within the firm. By 1986, the company was in deep trou ble. By the latter part of that year, the boom days had ended for the consume electronics industry. Although sales of consumer electronics were still increasing the rate of growth had tapered off considerably compared to the dramati growth rates realized by the industry during the early 1980s. Additionally, th consumer electronics industry had become saturated with retailers, particularl in major metropolitan areas such as New York City—Crazy Eddie's home base Increased competition meant smaller profit margins for Crazy Eddie and dimir ished Antar's ability to extract sweetheart deals from his suppliers.

Besides the problems posed by the increasingly competitive consumer elec tronics industry, Crazy Eddie faced a corporate meltdown by the late 1980s. Th tripling of the company's annual sales volume between 1984 and 1987 and th more complex responsibilities associated with managing a public company im posed an enormous administrative burden on Crazy Eddie's executives. Compli cating matters was the disintegration of Antar's inner circle of relatives, who ha served as his principal advisers during the first 15 years of his company's exis tence. Antar forced many of his relatives to leave the firm after they sided wit

3. J. E. Tannenbaum, "How Mounting Woes at Crazy Eddie Sank Turnaround Effort," *The Wall Street Journal*, 10 July 1989, A1, A4.

4. Belsky and Furman, "Calculated Madness," 26.

EXHIBIT 1
1984–1987 Balance Sheets of Crazy Eddie

CRAZY EDDIE, INC.
BALANCE SHEETS (000s omitted)

	March 1, 1987	March 2, 1986	March 3, 1985	May 31, 1984
Current assets:				
Cash	$ 9,347	$ 13,296	$22,273	$ 1,375
Short-term investments	121,957	26,840	—	—
Receivables	10,846	2,246	2,740	2,604
Merchandise inventories	109,072	59,864	26,543	23,343
Prepaid expenses	10,639	2,363	645	514
Total current assets	261,861	104,609	52,201	27,836
Restricted cash	—	3,356	7,058	—
Due from affiliates	—	—	—	5,739
Property, plant and equipment	26,401	7,172	3,696	1,845
Construction in process	—	6,253	1,154	—
Other assets	6,596	5,560	1,419	1,149
Total assets	$294,858	$126,950	$65,528	$36,569
Current liabilities:				
Accounts payable	$ 50,022	$ 51,723	$23,078	$20,106
Notes payable	—	—	—	2,900
Short-term debt	49,571	2,254	423	124
Unearned revenue	3,641	3,696	1,173	764
Accrued expenses	5,593	17,126	8,733	6,078
Total current liabilities	108,827	74,799	33,407	29,972
Long-term debt	8,459	7,701	7,625	46
Convertible subordinated debentures	80,975	—	—	—
Unearned revenue	3,337	1,829	635	327
Stockholders' equity:				
Common stock	313	280	134	50
Additional paid-in capital	57,678	17,668	12,298	574
Retained earnings	35,269	24,673	11,429	5,600
Total stockholders' equity	93,260	42,621	23,861	6,224
Total liabilities and stockholders' equity	$294,858	$126,950	$65,528	$36,569

is former wife in a bitter divorce. Even as Crazy Eddie's internal affairs spiraled nto chaos and the firm lurched toward financial disaster, Wall Street touted the ompany's stock as a "can't miss" investment.

In late 1986, Eddie Antar resigned as company president, although he retained he title of chairman of the board. A few weeks later, he simply dropped out of ight. In the absence of Antar, Crazy Eddie's financial condition worsened apidly. Poor operating results that the company reported for the fourth quarter f fiscal 1987—which ended March 1, 1987—sent Crazy Eddie's stock price into a ailspin from which it never recovered. In November 1987, a takeover group eaded by two prominent financiers gained control of the company. A company-vide physical inventory taken by the new owners uncovered the $65 million

EXHIBIT 2
1984–1987 Income Statements of Crazy Eddie

CRAZY EDDIE, INC.
INCOME STATEMENTS (000s omitted)

	Year Ended March 1, 1987	Year Ended March 2, 1986	Nine Months Ended March 3, 1985	Year Ended May 31, 1984
Net sales	$ 352,523	$ 262,268	$ 136,319	$ 137,285
Cost of goods sold	(272,255)	(194,371)	(103,421)	(106,934)
Gross profit	80,268	67,897	32,898	30,351
Selling, general and administrative expense	(61,341)	(42,975)	(20,508)	(22,560)
Interest and other income	7,403	3,210	1,211	706
Interest expense	(5,233)	(820)	(438)	(522)
Income before taxes	21,097	27,312	13,163	7,975
Pension contribution	(500)	(800)	(600)	—
Income taxes	(10,001)	(13,268)	(6,734)	(4,202)
Net income	$ 10,596	$ 13,244	$ 5,829	$ 3,773
Net income per share	$.34	$.48	$.24	$.18

shortage of inventory alluded to earlier. That inventory shortage, which wa larger than the total profits the company had reported since it went public in 1984 would eventually plunge Crazy Eddie into bankruptcy and send regulatory au thorities in pursuit of Eddie Antar for an explanation.

CHARGES OF ACCOUNTING IRREGULARITIES

Extensive investigations of Crazy Eddie's financial records by the new owner: and regulatory authorities culminated in fraud charges being filed against Eddi Antar and his former associates. The SEC alleged that after Crazy Eddie wen public in 1984, Antar became preoccupied with the price of his company's stock Antar realized that Crazy Eddie had to keep posting impressive operating result: to maintain the upward trend in the stock's price. An SEC investigation reveale that within the first six months after the company went public, Antar ordered a subordinate to overstate inventory by $2 million, resulting in the firm's gros: profit being overstated by the same amount. The following year Antar orderec year-end inventory to be overstated by $9 million and accounts payable to be un derstated by $3 million. Court records documented that Crazy Eddie employee: overstated year-end inventory by preparing inventory count sheets for items tha did not exist. To understate accounts payable, employees prepared bogus debi memos and entered them in the company's accounting records.

As the economic fortunes of Crazy Eddie began to fade in the late 1980s Antar became more desperate in his efforts to enhance the company's reportec revenues and profits. He ordered company employees to include in inventor consigned merchandise and goods being returned to suppliers. Another fraudulent tactic Antar used to overstate inventory involved transhipping transactions, the large volume transactions between Crazy Eddie and many of its smaller competitors.

Antar knew that financial analysts closely monitor the annual percentage change in "same store" sales for retailers. Any decline in this percentage is typically seen as a strong negative indicator of a retailer's future financial performance. As the consumer electronics industry became increasingly crowded, the revenues of Crazy Eddie's individual stores began to fall, although the firm's total revenues continued to climb due to new stores being opened each year. To remedy the drop in same store sales, Antar instructed his employees to record selected transhipping transactions as retail sales of individual stores. For instance, suppose that Crazy Eddie sold 100 microwaves costing $180 each to another retailer at a per-unit price of $200. The $20,000 in sales would be recorded as retail sales with a normal gross profit margin of 30 to 50 percent—meaning that inventory would not be credited for the total number of microwaves actually sold. This practice killed two birds with the proverbial stone. Same store sales were inflated for selected operating units, and inventory was overstated with a corresponding increase in gross profit from sales.

WHERE WERE THE AUDITORS?

"Where were the auditors?" was a question posed repeatedly by investors, creditors, and other interested parties when the public learned of the Crazy Eddie fraud. Four different accounting firms audited Crazy Eddie's financial statements over its turbulent history. Antar dismissed Crazy Eddie's first accounting firm, a local firm, before he took the company public. The underwriter that managed Crazy Eddie's IPO urged Antar to retain a more prestigious accounting firm to increase the public's confidence in the company's financial statements. As a result, Antar retained Main Hurdman to serve as Crazy Eddie's audit firm. Main Hurdman had a nationwide accounting practice with several prominent clients in the consumer electronics industry. In the mid-1980s, Peat Marwick became Crazy Eddie's audit firm when it merged with Main Hurdman. Following the corporate takeover of Crazy Eddie in 1987, the new owners replaced Peat Marwick with Touche Ross.

Much of the criticism triggered by the Crazy Eddie scandal centered on Main Hurdman and its successor, Peat Marwick. Main Hurdman charged Crazy Eddie comparatively modest fees for the company's annual audits. A leading critic of major accounting firms alleged that Main Hurdman had "lowballed" to obtain Crazy Eddie as an audit client, realizing that it could make up for any lost audit revenue by selling the company consulting services.

> In one year, Main Hurdman charged only $85,000 to do a complete audit of Crazy Eddie—a business with hundreds of millions of dollars in reported revenues, dozens of retail stores, and two large warehouses. At the very same time that Main Hurdman was charging the bargain basement price of $85,000 for supposedly conducting an audit, its consulting division was charging Crazy Eddie millions of dollars to computerize Crazy Eddie's inventory system.[5]

5. M. I. Weiss, "Auditors: Be Watchdogs, Not Just Bean Counters," *Accounting Today*, 15 November 1993, 41.

This same individual challenged Main Hurdman's ability to objectively audit an inventory system that it had effectively developed. Main Hurdman's independence was also questioned because many of Crazy Eddie's accountants were former members of that accounting firm. Critics charge that a company that hires one or more of its former auditors can more easily conceal fraudulent activities during the course of subsequent audits. That is, a former auditor may help his or her new employer undermine subsequent audits. In fact, Crazy Eddie's practice of hiring its former auditors is not unusual. Many accounting firms actually arrange such "placements" with audit clients.

> You would think that if an auditor wanted to leave a public accounting firm, he or she would be discouraged from going to work for clients they had audited. Instead, just the opposite is true with big accounting firms encouraging their personnel to work for clients in the apparent belief that it helps cement the accountant-client relationship.[6]

Most of the criticism directed at Crazy Eddie's auditors stemmed from their failure to uncover the huge overstatement of the company's inventory and the related understatement of accounts payable. Third parties who filed suit against the auditors accused them of "aiding and abetting" the fraud by failing to thoroughly investigate numerous suspicious circumstances they discovered. Of particular concern were several reported instances in which the auditors requested client documents, only to be told that those documents had been lost or inadvertently destroyed.

In Peat Marwick and Main Hurdman's defense, Antar and his associates engaged in a large-scale plan to deceive the auditors. For example, after determining which inventory sites the auditors would be visiting at year-end, Antar shipped sufficient inventory to those stores or warehouses to conceal any shortages. Likewise, Crazy Eddie personnel systematically destroyed incriminating documents to conceal inventory shortages from the auditors. Antar also ordered his employees to "junk" the sophisticated, computer-based inventory system designed by Main Hurdman and to return to the outdated manual inventory system previously used by the company. The absence of a computer-based inventory system made it much more difficult for the auditors to determine exactly how much inventory the firm had at any point in time.

A particularly disturbing aspect of the Crazy Eddie scandal was the involvement of several key accounting employees in the various fraudulent schemes. These parties included the director of the internal audit staff, the acting controller, and the director of accounts payable. Past audit failures demonstrate that a fraud involving the collusion of key accounting personnel is extremely difficult for auditors to uncover.

EPILOGUE

In June 1989, Crazy Eddie filed a Chapter 11 bankruptcy petition after losing its line of credit. Later that year, the company closed its remaining stores and liquidated its assets. Meanwhile, Eddie Antar was named as a defendant in several lawsuits, including a large civil suit filed by the SEC and a criminal indictment

6. *Ibid.*, 42.

filed by a U.S. district attorney. In January 1990, a federal judge ordered Antar to repatriate $52 million that he had transferred to foreign bank accounts in 1987. The following month, federal marshals began searching for Antar after he failed to appear in federal court. A judge had scheduled a hearing to force Antar to account for the funds he had transferred to overseas bank accounts. After Antar surrendered to federal marshals, the judge found him in contempt and released him on his own recognizance. Following this court appearance, Antar became a fugitive. For the next two years, Antar eluded federal authorities despite reported sightings of him in Brooklyn, South America, and Jerusalem.

On June 25, 1992, Israeli police arrested Eddie Antar. At the time, he was living in a small town outside Tel Aviv and posing as an Israeli citizen, David Jacob Levi Cohen. On December 31, 1992, Antar's attorney announced that an extradition agreement had been reached with the U.S. Justice Department and Israeli authorities. After being extradited, Antar was convicted in July 1993 on 17 counts of financial fraud including racketeering, conspiracy, and mail fraud. In May 1994, a federal judge sentenced Antar to 12 and one-half years in federal prison and ordered him to pay restitution of $121 million to former stockholders and creditors.

A federal appeals court overturned Antar's fraud conviction in April 1995. The appeals court ruled that the judge who had presided over Antar's trial had been biased against him and ordered that a new trial be held under a different judge. In May 1996, Antar's attorneys and federal prosecutors arranged a plea bargain agreement to settle the charges outstanding against him. Under the terms of this agreement, Antar pleaded guilty to one federal charge of racketeering and publicly admitted, for the first time, that he had defrauded investors by manipulating his company's accounting records. Following his admission of guilt, one of the prosecuting attorneys commented that "Crazy Eddie wasn't crazy, he was crooked."[7]

In early 1997, Eddie Antar was sentenced to seven years in federal prison. Antar, who had remained in prison since being extradited to the United States in 1993, received credit for the time he had already spent in prison. As a result, he was required to serve only two years of the seven-year prison sentence.

Several of Antar's former cohorts have also been convicted or have pleaded guilty to fraud charges, including Sam E. Antar, Eddie Antar's brother and Crazy Eddie's former CFO. After being released from prison, Sam E. Antar openly described and discussed his role in the fraud masterminded by his brother. He revealed that Eddie had financed his college degree in accounting because the family needed an expert accountant to help design, manage, and conceal the company's fraudulent schemes. Sam graduated *magna cum laude* in accounting and passed the CPA exam on his first attempt. Upon joining Crazy Eddie, Sam confessed that he became a "cold-blooded thug" and a willing participant in the massive fraud. "I hurt a lot of people. A lot of people lost their life's savings."[8]

In March 1993, an agreement was reached to settle dozens of pending civil lawsuits triggered by the Crazy Eddie fraud. The contributions of the various defen-

7. F. A. McMorris, "Crazy Eddie Inc.'s Antar Admits Guilt in Racketeering Conspiracy," *The Wall Street Journal*, 9 May 1996, B7.

8. G. Cheney, "How Crazy Was Crazy Eddie?" *Accounting Today*, October 26–November 8, 1998, 1, 61.

dants to the $42 million settlement pool were not disclosed; however, the defendants contributing to that pool included Peat Marwick and the local accounting firm used by Crazy Eddie before the company went public. To date, authorities have recovered more than $150 million from the parties that profited from the fraud. These funds include more than $40 million that a federal judge ordered Sam Antar, Eddie Antar's father, to surrender in August 2002.

In the late 1990s, Eddie Antar's mother purchased the Crazy Eddie logo and the company's former advertising catch phrase, "Crazy Eddie—His prices are insane!" that had been sold in bankruptcy proceedings years earlier. In 1998, two nephews of Eddie Antar revived their uncle's business. Presently, Crazy Eddie operates principally as a mail-order and Internet-based retailer of consumer electronics. In June 2001, a New York business publication reported that the company had hired a former executive in the consumer electronics industry to serve as the "creative force" behind its marketing efforts.[9] That individual was none other than Crazy Eddie Antar.