

## URC RESEARCH REPORT

Project Code: RI 108218

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**Project Title:** **Stained Carpet: A case study of the collapse of Feltex Carpets Ltd**

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### 1. What is(are) the research question(s)?

A teaching case study has been developed on the events that surrounded Feltex Carpets Limited initial public offering (IPO) and the subsequent collapse of the company two years later. A company that was once considered as a New Zealand icon left many employees, creditors and shareholders pondering how did this happen?

The case raises a number of issues about the roles of various players in an IPO and their motivations. The case also highlights the role of the external auditor and the expectation gap between auditors and the users of financial statements.

### 2. Rationale

Feltex provides a recent, real series of events about a business failure shortly after the business had been promoted and publicly listed. The failure resulted in a number of small New Zealand investors losing money invested in Feltex.

There has been much debate about the cause of the collapse so shortly after it was listed. Questions have been raised in the media as to whether the collapse was due to shortcomings in corporate governance systems or the collapse was simply due to the risks of doing business.

There are few Australasian instructional cases available for describing and analysing the adverse consequences of corporate collapse and the involvement of corporate governance systems in the collapses. The Feltex experience provides a unique Australasian case particularly appropriate for local use but also useful for students worldwide who can view events in an institutional structure different from their own.

### 3. Methodology

The following approach was adopted:

1) Publicly available information was collected on Feltex. This was accessed from sources such as news media, professional journals, regulators such as the New Zealand Securities Commission, shareholders association, company records, annual reports, prospectuses, and industry statistics.

2) The historical background of the company was documented and the industry in which the company operated.

- 3) An industry analysis identifying the strengths, weaknesses, opportunities and threats (i.e., a SWOT analysis) was compiled.
- 4) A time line of key events prior and subsequent to the IPO was established
- 5) Analysis was conducted on Feltex's financial performance over a number of periods prior and subsequent to the IPO
- 6) Feltex's share price performance after the IPO was tracked and graphed.
- 7) The main players were identified and their roles in the IPO with a focus on internal and external governance mechanisms:
  - a) Internal governance mechanisms:
    - i. The structure of the board of directors (board size, board independence, board committee structure)
    - ii. A profile of the board of directors including qualifications and industry experience
    - iii. Recorded key board decisions and the background to those decisions
  - b) External governance systems. Assessed the roles of reach of the following:
    - i. Capital market regulators – the New Zealand Securities Commission and New Zealand Exchange
    - ii. The vendors
    - iii. The promoters
    - iv. Equity analysts
    - v. External auditors
- 8) The role of each of the players to corporate governance principles and best practice was investigated.

#### **4. Outcomes / findings**

The project produced a case for instructional use. Distribution is anticipated through publication in a respected refereed case journal.

The case study traces the history of the company and identifies the key players and the industry elements unique to Feltex. The IPO document is analysed in detail, together with the deterioration and collapse of the company. Students are to evaluate the elements of the IPO and to consider the motivations of the vendors, the risks of the business and identify and assess any misleading information.

The case provides a combination of teaching topics, including understanding business risks, financial statement analysis, and corporate governance.

#### **5. Publications and dissemination**

A submission to AFAANZ conference in early July 2009 has been made in mid-February and awaiting feedback (expected mid-April). The intention is to target the journal *Issues in Accounting Education* after receiving feedback from the conference.