

Theranos Case Study: What Went Wrong?





Objectives

- ▶ Discuss how a young college dropout hoodwinked major venture capitalists
- ▶ Discover the 8 signs of trouble that were overlooked and resulted in a \$9 Billion fraud scheme
- ▶ Explore these key questions
 - ▶ Would an effective compliance program cause the startup to fail or succeed?
 - ▶ What is the role of the compliance professional when faced with signs of fraud?
 - ▶ Is an industry that affects people's lives held to a higher standard?

CHANGE THE WORLD WITH A DROP OF BLOOD

— Elizabeth Holmes



8 Signs of Trouble

Signs of Trouble #1

Secret Technology

- ▶ Walgreens executives were not allowed in the lab to examine data
- ▶ CMS surveyors were not aware of the secret lab
- ▶ Used “trade secrets” as their defense
- ▶ Employees worked in silos and were not permitted to share information with each other

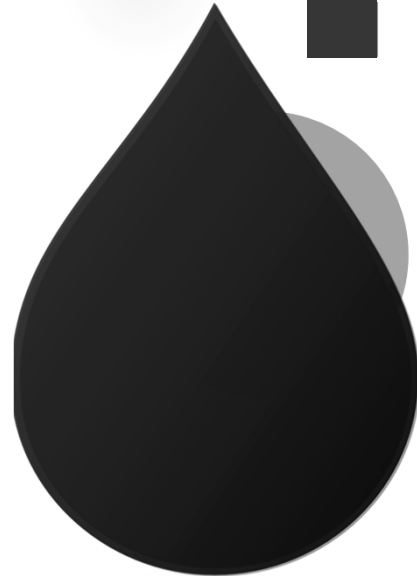
Signs of Trouble #2

Smitten with the new female Steve Jobs

- ▶ Forbes estimated the value at \$9 Billion (\$9,000,000,000) despite absence of scientific studies
 - ▶ Sales never topped \$100 Million
- ▶ Powerful Board members (such as former Secretaries of State George Schultz & Henry Kissinger, former General of Armed Forces James Mattis [recently Secretary of Defense], & former senator Bill Frist) overlooked obvious shortcomings
- ▶ Graced the cover of New York Post, Wall Street Journal, and Time
- ▶ Sought after speaker

REVOLUTIONIZE HEALTHCARE!

- Elizabeth Holmes



Signs of Trouble #3

Culture of Retaliation

- ▶ Some employees doubted accuracy of results
- ▶ High turnover – employees were fired for disagreeing with Elizabeth Holmes
- ▶ Tyrant COO – Sunny Balwani
- ▶ Signed covenants upon termination

Signs of Trouble #4

Dazzled Investors

- ▶ Aggressive boasts were not challenged by investors
- ▶ Investors dazzled by Elizabeth & the potential innovation that could “change healthcare”
- ▶ Never demanded an answer to: Does this thing really work?”

ONE TINY DROP
CHANGES
EVERYTHING – Elizabeth Holmes



Signs of Trouble #5

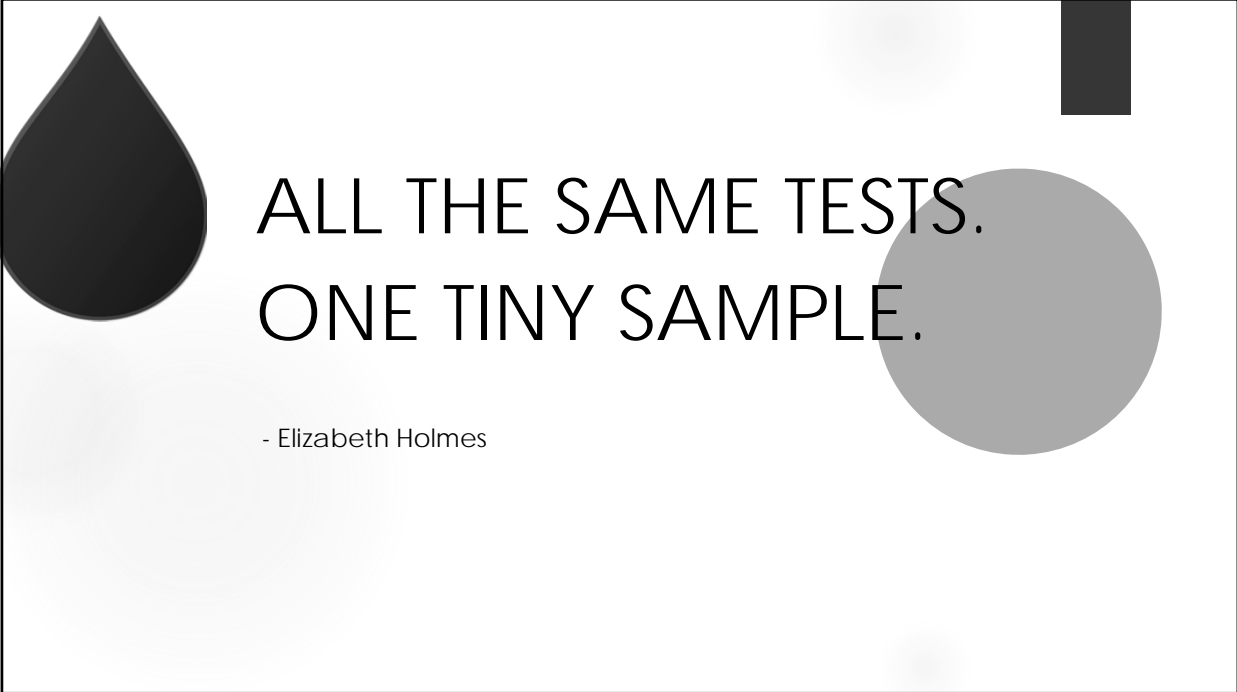
Implied Endorsements

- ▶ Employees wrote flattering reports about company products
- ▶ Employees put logos of pharma companies on reports

Signs of Trouble #6

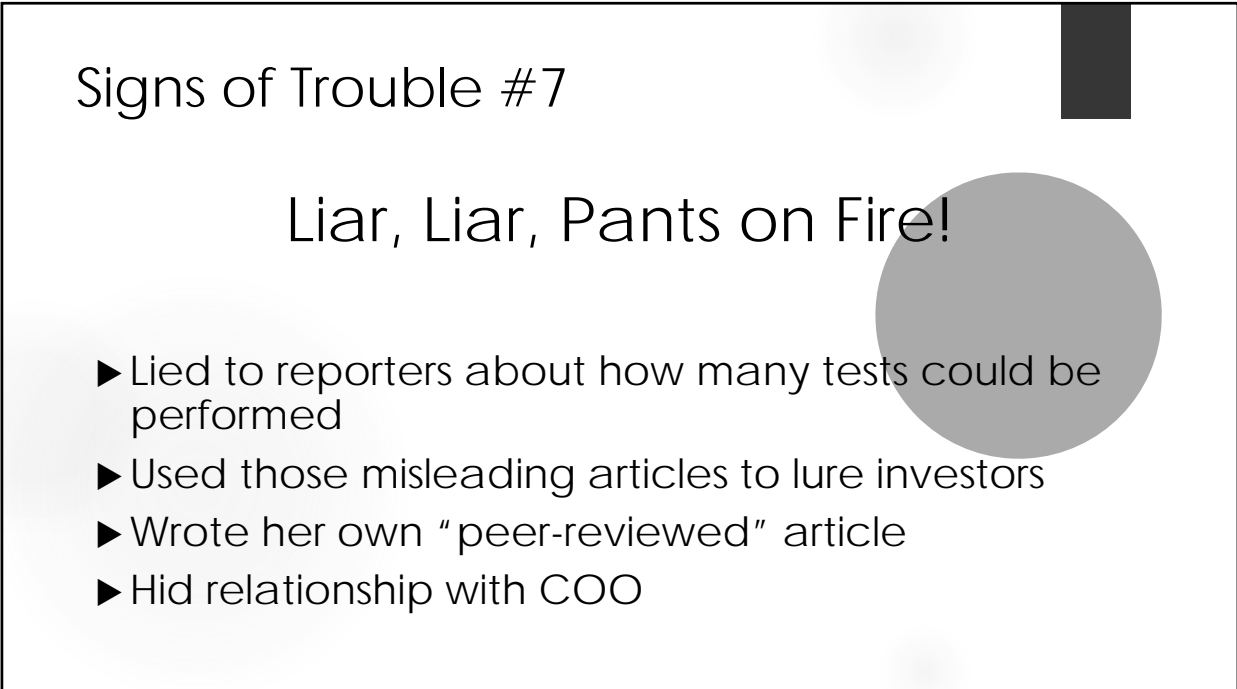
Rolled out Defective Machines

- ▶ Received millions from Walgreens to rollout testing
 - ▶ Diagnostic tools were not ready
 - ▶ Lied to Walgreens, rather than request more time
 - ▶ In 2013, opened 42 wellness centers in AZ, 2 in CA, & 1 in PA
- ▶ Passed off 3rd party testers as its own
 - ▶ Engineers modified standard testing machines to make them look like Theranos's new "mini-Labs"



ALL THE SAME TESTS.
ONE TINY SAMPLE.

- Elizabeth Holmes



Signs of Trouble #7

Liar, Liar, Pants on Fire!

- ▶ Lied to reporters about how many tests could be performed
- ▶ Used those misleading articles to lure investors
- ▶ Wrote her own "peer-reviewed" article
- ▶ Hid relationship with COO

Signs of Trouble #8

No Compliance Professional

- ▶ No compliance committee until 2016
- ▶ Elizabeth had majority shares for votes and no one to check her – founder, chairwoman, & CEO
 - ▶ Total control by founder is not uncommon in Silicon Valley start-ups

Polling Question

- ▶ How would an effective compliance program have affected the startup's success?
 - ▶ Greater chance of success
 - ▶ Greater chance of failure
 - ▶ No impact
 - ▶ I don't know

Holmes explains the process:

A chemistry is performed so that a chemical reaction occurs and generates a signal from the chemical interaction with the sample, which is translated into a result, which is then reviewed by certified lab personnel.

Plaque on Holmes's desk:

**WHAT WOULD YOU DO IF YOU
KNEW YOU COULD NOT FAIL?**

Status as of January 2019

Holmes settled with the SEC for "massive fraud"

- Not required to admit wrongdoing
- Forced to surrender control of Theranos
- Banned from serving as a director or officer of any public company
- Return 18.9 million shares of stock
- Pay penalty of \$500,000

Status as of January 2019

There is still a major criminal investigation by the FBI

Sunny Bulwani refused to settle and is awaiting trial

Elizabeth Holmes is currently soliciting investors for a new Silicon Valley start-up!

I DON'T KNOW

-Elizabeth Holmes

-600+ times in 2017 deposition

What would you do?

- ▶ What is the role of the compliance professional when faced with signs of fraud?
 - ▶ "Conscience of the organization"
 - ▶ Board reporting
 - ▶ Outside legal counsel

Polling Question

▶ Is an industry that affects people's lives held to a higher standard?

- ▶ Yes
- ▶ No
- ▶ Maybe
- ▶ I don't know

Questions?

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