The Fall of Enron

A CRITICAL ANALYSIS OF BUSINESS FAILURES

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FALL 2024 | CPD 494

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In the world of business, taking risks and chances are integral to achieving considerable amounts of success. Simply choosing to play it safe and navigate the market conservatively may yield some results, but the true giants of the business and entrepreneurial world (Gates, Jobs, Zuckerberg) did not get to the thrones that they currently reside on by taking the safer path. But with the success stories that are put in the spotlight, there are even more tales of catastrophic disasters that shook the business world. One notable and particular instance of this is the tale of Enron Corporation, which involves a former American energy, commodities, and services company based out of Houston, Texas. In the early 2000s, Enron Corporation was a giant in multiple industries, with over 30,00 employees and annually raking in a revenue of approximately 100 billion dollars. It was a sort of blueprint for aspiring large corporations and was praised by many in the business world. Enron was even fortunate enough to win the award for "America's Most Innovative Company" presented by Fortune magazine on multiple occasions (6 consecutive years, to be exact). Additionally, Enron was named Fortune magazine's "Best Company to Work For" in 2000, further boosting its positive reputation. But what seemed like a shining example in the world of business would soon come crumbling down in a swift demolition that would serve as a lasting reminder to the world of entrepreneurship. As it turns out, the energy giant was another case of something "too good to be true", as it was placed under the microscope of the federal government. A federal probe into the company's operations resulted in a bankruptcy filing in December of 2001 and left a path of ruin and destruction for those entangled in the Enron web.

Taking a deeper look at the origin of Enron, the company’s roots can be traced all the way back to the year 1985. A merger was struck between the companies Houston Natural Gas and InterNorth, based in Omaha, Nebraska. The joining of these two companies laid the groundwork for what would become Enron Corporation. The CEO of the Houston Natural Company Ken Lay was appointed as the acting CEO and chairman of Enron and was tasked with leading the budding company. The company incurred debt on the heels of its merger, meaning that a new business plan and strategy had to be developed quickly to begin the climb out of the financial hole. The CEO Lay then turned to a firm known as Mckinsey and Co. to take charge in developing a new innovative strategy that Enron would adopt as its own. Mckinsey and Co. move to hire Jeffrey Skilling, a young businessman that boasted a background in the areas of asset management and banking. Skilling had an ambitious vision for Enron, one that impressed Lay enough to appoint Skilling the head of the newly formed Enron Finance Corp, a subdivision of Enron. In addition to Skilling, a man named Andrew Fastow was hired to by the chief financial officer in 1998, and he would play a pivotal role in the loss-hiding schemes that would transpire in the coming years. With their leadership set into place, Enron now ventured forward to begin their rise to financial prominence and market domination in the energy industry.

Enron experienced a rise to prominence of meteoric proportions. In his new position of power, Skilling took charge in converting Enron’s method of accounting from the more traditional method of historical costs towards a new method, called mark-to-method accounting or MTM. MTM accounting works by measuring the fair value of accounts with potential for change or fluctuation over time, such as assets and liabilities. MTM also serves to provide an estimated value of a company or business’ financial situation. Though MTM is very much a concrete and legitimate form of accounting, there are certain loopholes and flaws to the method that can be exploited. These exploitations were put into full effect by Skilling and Enron, to the point that Enron's profits and revenue continued to appear to be booming, though this was very much the opposite of what was occurring. To aid Skilling is his MTM ventures, Fastow used his power position to develop a plan that would showcase the company being in sound shape despite it actually losing money. To do this, Fastow created a network of companies that would serve as the targets for the write-offs that would hide Enron's declining finances.

There were multiple factors that ultimately led to the downfall of Enron Corporation. But perhaps the two biggest were the inherent flaws in the usage of MTM accounting and the poor choices in company leadership, leading to poor business decisions being made by said leaders. The first of these factors lies within the way that Enron conducted their financial reporting. There was severe mismanagement regarding the reporting of losses by Enron, where the losses of the company were hidden using the loopholes of MTM accounting. Skilling would operate by having some sort of asset built and consequently claiming the projected profit of the asset in the company's financial books. In spite of the lack of positive returns on the asset, the financial books would not reflect it accurately. In the often occurrence that said asset did not meet the projected profit, Enron would then proceed to transfer it to a corporation that was off-the-books instead of simply accepting the financial loss. Being that the loss would then go without being reported, Enron was then able to write off ventures that did not result in positive returns without hurting the net income of the company on its income statement. As far as leadership is concerned, the corruption that was personified by Skilling and Fastow was rampant and poisoned the company from the top-down. They made the conscious choices to operate in an underhanded manner in order to reach high levels of prominence in the business world, bypassing the fact that thousands of their employees, customers, and investors would suffer greatly once the faux kingdom was sieged by authorities. With better choices in leadership, Enron may not have achieved the astronomic heights that it did, but it might still be present as a middle-tier company had it operated in a more admirable way.

When reflecting back on the Enron debacle through the lenses of budding entrepreneurs, there are many lessons that can be taken from it, though two in particular seem to stick out above all others. One such lesson is honesty regarding financial reporting. The utilization of MTM accounting in an underhanded manner was able to momentarily bring success to Enron, albeit in a phony sense. However, this method eventually caught up tenfold to Enron, being one of the major contributing factors to the company's downfall. Second, there was a common theme of corruption and poor leadership within and around the Enron ecosystem. Skilling was entrusted with massive amounts of power and oversight within the organization, and he chose to operate in a way that was devoid of moral obligations to ensure legitimate growth and stability for all of his subordinate employees. Fastow spearheaded the efforts and plans to create a web of companies that would support the stashing away of Enron's losses, also serving to undermine the business principles of a good company and forgoing his moral obligations to his subordinates. So, for the second lesson, it would be in the best interest of a company to truly do a deeper dive into the intentions and psyche of potential leaders within the organization. Having great leadership at the top of the ecosystem will only serve to trickle down towards the employees, thus creating a productive and supportive work environment that will greatly increase the chances of any success being sustained over the long term.

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