

# Ethical Erosion at Enron

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## INTRODUCTION

Enron Corporation, the seventh-largest company in the nation, was named “America’s Most Innovative Company” by *Fortune Magazine* from 1989 through 2001. Ironically, the company collapsed spectacularly in 2001 into bankruptcy and set off a wave of investigations into corporate malfeasance. The failure of both fiscal regulators and business analysts to notice the deterioration at Enron can debatably be labeled as the biggest business ethics failure in corporate history. The focus of this article is on the failure of Enron in conducting e-commerce due to unethical employee issues. Enron engaged in a series of complex transactions specifically to mask its activities. And yet the company saw no need to pay taxes in four of the last five years of its existence.

Scandals at Enron scared the public. The Enron implosion led to a major confidence crisis in the United States. While pushing off-the-books accounting to new levels on the one hand, Enron on the other hand innovated some very forward-looking projects, and what began as a smart business plan ended in disaster. To provide insight into what additional disclosures might be needed, it is useful to examine just how the current U.S. financial reporting model failed the markets in the Enron debacle. In ensuring that another Enron is not taking place, we hope to shed a modest amount of illumination upon the Enron scandal.

## BACKGROUND

Enron was formed in 1985 when a Houston natural gas company merged with InterNorth, a gas provider in

Nebraska, to operate an interstate natural gas pipeline that linked the Great Lakes with Texas. Kenneth Lay, a former Exxon executive, became chief executive officer (CEO) of Enron in 1986. Enron began trading gas commodities in 1989 and soon became the largest supplier in the United States. The business activities of Enron spread all around the world and included activities in countries like Argentina, Bolivia, Brazil, China, India, Indonesia, Mozambique, and the Philippines (Chatterjee, 2000). Enron also diversified its product range and expanded on to the Internet, trading a wide range of products from pulp and paper to petrochemicals and plastics. It also traded esoteric products such as airport landing rights, railroad hauling capacity, and clean air credits.

In less than two decades, Enron grew from a small gas pipeline company into the world’s leading energy trading company, with \$100 billion in revenue, \$60 billion market value, and 21,000 employees in 40 countries (Enron, 2002). In 2000 Energy Financial Group ranked Enron as the sixth largest energy company worldwide. Enron’s mergers brought the company much success, but Enron wanted more. This phenomenal growth was made possible by the use of new market strategies that tilted towards knowledge and innovation, in place of traditional ownership of physical assets.

The central strategy at Enron was to use the financial derivatives in the market to acquire commodities that anybody wanted to sell and dispose it at a profit to anyone who required it. This started with oil and natural gas, and then expanded into electric power generation and pipeline capacity, broadband communication, and freight capacity of modular containers. From “energy supplier” to “energy broker” to “multiple-item broker,” all these were the factors that were

responsible for Enron's growth, and corporate greed led to its downfall (Ekbia, 2004).

## MAIN FOCUS

From the *postal coupon scam* in the 1920s to the *mutual funds scam* in the 1970s, from the *securities fraud scam* in the 1980s to the *junk bond scam* and *insider trading scam* afterwards, none could overshadow the *Enron scam* in terms of magnitude and depth. Enron engaged in the use of electronic technology to facilitate business transactions and managed to create the largest e-commerce Web site in the world. However, what began as a smart business decision ended in a disaster. Gini (2004) stressed that Enron has become "an icon of an era, the poster child for corporate mismanagement, a metaphor for corporate corruption, and, a shorthand for corporate greed" (p. 9).

## Meteoric Rise and Sudden Fall

E-commerce provides numerous opportunities in increasing networking efforts, increasing efficiency, hence decreasing costs. Enron launched EnronOnline (EOL) in November 1999, the first ever global, Web-based, online commodity trading site. EOL was a principal-based online trading system. All transactions were directly with an Enron company. Customers could view real-time prices and accept full contractual terms online, such as Argentine natural gas, Japanese weather, Dutch aluminum, Spanish electricity, and U.S. lumber. Enron had an edge over its competitors in that there was no commission and no subscription fee charged to the customer. The key factor that separated Enron from its competition was the way it interacted with its buyers and sellers. In addition, Enron offered a risk management product to these buyers and sellers to make them comfortable with this new marketing exploit by hedging their financial exposures. Enron played three different roles at the same time: broker, trader, and market maker.

In early 2001 Jeff Skilling took over as Enron's CEO from Ken Lay. In October 2001 the tables were turned again, and Ken Lay returned as CEO with Jeff Skilling having resigned in August. Then hints of overstated earnings began to circulate, along with nose-dived share prices—employees were terminated and their life savings emptied. Investigations into corporate

crimes and accountancy fraud were initiated on Enron leading to the collapse of the Enron empire (Siylak, 2002). Enron declared bankruptcy in December 2001. Quite a few of its executives reaped large benefits by disposing their stock options for cash when the share prices were high. The employees were the losers as they put all their pension money in Enron shares and lost it all when the firm went bankrupt.

## How the Company was Directed

Virtually every company, including those that plunder, has a policy with the proper lofty language about their commitment to integrity. But there is a difference between words and deeds (Wright, 2003). It is an irony that at the time these companies were engaged in wrongdoing, they were never more eager to present themselves as good citizens.

Enron's token commitment to its code of ethics was famed "RICE" (respect, integrity, communication, and excellence). Enron's values are set forth in its 2000 Annual Report to Shareholders:

*Communication—We have an obligation to communicate. Respect—We treat others as we would like to be treated ourselves. Integrity—We work with customers and prospects openly, honestly and sincerely. Excellence—We are satisfied with nothing less than the very best in everything we do.* (Enron, 2001)

However, the RICE values were neither modeled by leaders nor integrated into operations. Enron was obsessed with values relating to business success and profitability. Risk taking and "do deals" had become the dominant value in the company. Enron adopted an aggressive employee review system—a semiannual weeding out known as the "rank and yank." In the performance review committee (PRC), which became known as the harshest employee ranking system in the country, every six months 15% of employees were to be given unsatisfactory ratings that largely doomed their careers at Enron.

The company's culture had profound effects on the ethics of its employees. Enron's former President and CEO Jeff Skilling actively cultivated a culture that would push limits. Employees were forced to stretch the rules further and further until the limits of ethical conduct were easily overlooked in the pursuit of the next big success. Fierce internal competition prevailed.

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