Enron: Widespread myopia

History and development until 2000

Enron was created in 1986 following the merging of two companies specialising in gas (production and transport): Houston Natural Gas and Internorth. The company specialised in gas production and transport and declared its aim of becoming a world leader in energy trading at a time when markets were being deregulated. Alongside Enron disposed assets, considered to be non-strategic (industrial assets in the United States), it launched into a diversification of its businesses particularly by means of an extremely active policy of acquisitions carried out at a very rapid rate.

We consider that there are four main phases explaining Enron's transformation from a utility and a pipe line company to a market-maker in energy, commodity and derivatives. These phases reflecting the four main lines of development strategy are shown in Table 1 below. In the space of 15 years, Enron becomes world number one in the electricity trading sector. It was the seventh largest company in sales terms in the United States in the year 2000.

TABLE 1 - Changes in Enron's business activities
Phase 1 (1985–1989)
Industrial activity of gas production and transport, and electricity production and transmission
Phase 2 (1990–1996)
Start of business diversification into energy distribution, raw materials trading and services. Diversification of businesses into trading in a large number of commodities (gas, electricity, coal, wood, paper, resins, plastics, metals, etc.).
Phase 3 (1997–1999)
Continuation and acceleration of the international strategy of diversification into trading (wholesale energy, retail energy and broadband)
Phase 4 (1999 onwards)
Global online trading activity. Creation of "EnronOnLine", the first global raw materials trading site. Enron was one of the leaders in the development of electronic marketplaces.

The table illustrates the savage and unrestrained diversification adopted by Enron, without any consistent strategic vision with regard to **its core activity**. Enron's activities relied primarily on delivering and brokering energy domestically in a deregulation context that led to spot prices' increases for electricity and natural gas. **Then**, Enron "pioneered markets for commodities that had never been traded before, including fiber-optic bandwidth, pollution-emission credits and weather derivatives," running an on-line exchange (EnronOnLine), one of the largest e-commerce sites. Enron changed itself into mainly an unregulated derivative-trading entity.

This restless movement into new activities did not signal underlying problems; rather **it** was taken as evidence of management prowess. **In fact**, before the collapse and at that time, this business strategy gave rise to highly enthusiastic comments, suggesting that Enron was a successful model for companies moving from the "old economy based on industrial production" to the "new economy based on services and knowledge". Enron exemplifies **this transition** to a "new economy based on knowledge".

Business schools, academic, media and experts endorsed Enron success in plunging in uncertainty and navigating in the new world of deregulated energy. According to Business Week (24 July 2000), Enron was the sleepy pipe line company that had reinvented itself as an energy trader and maker. And Fortune (that in April 2000 published a long tribute to Enron) ranked it, five times, as the "most innovative company" in the United States because it had struck upon repeated value innovation which allowed a serious decrease of the cost of gas and electricity to customers by as much as 40–50%. **This** was possible while Enron was reducing dramatically its own cost structure by "for example, creating the first national spot market for gas in which commodity swaps, future contracts and other complex derivatives effectively stripped the risk and volatility out of gas prices".

In brief, Enron was highly regarded by media, academic professors and stock market analysts because it has broken the capital-intensive business model of the gas and electric provider. After paying the fixed costs and by applying these tools to infinite transactions at insignificant marginal cost, Enron succeeded in increasing returns. And **this innovative success** was endlessly recycled by business press, by academic strategists "always trying to find business cases that proved their point", and essentially by Enron executive managers.

Synopsis of the Enron strategy

The resource-based view has become an influential approach for analyzing corporate strategy. **It** is based on the idea that the organization can be studied as a set of resources, which may differ depending on the company. In this approach, the aim is not to focus on the external environment of the company but instead to thoroughly analyze the company's resources. The resources are of various kinds: physical (machines and plant locations), human (qualifications and degree of adaptability of personnel) and financial. They may also be intangible and may be based on goodwill (existence of intangible assets such as a patent, brand or know-how). “Resources and capabilities can be viewed as bundles of tangible and intangible assets, including a firm's management skills, its organizational processes and routines, and the information and knowledge (that) it controls.” Intangible assets are particularly important in that they are hard to access and imitate. They often constitute strategic resources, **i.e.** unique resources from which the company's competitive advantage stems.

The analysis of the strategic capacity of a company depends on three main factors. The concept of resources is thus often associated with the concept of organizational competences, **i.e.** the routines, know-how and processes that are specific to the company. They must be hard to imitate in order to create a lasting advantage. They form part of the “core competencies that are the collective learning in the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies.” **More**, these competencies “enable the organization to outperform its competitors or to offer a level of value that is clearly superior.” The third element is balance between the resources, which involves referring to the concept of Strategic Business Units (SBU) in order to arrive at the most comprehensive vision of the company's strategy, enabling a definitive judgement to be made about the balance (or imbalance) of the business portfolio.

This approach enables us to arrive at an evaluation in terms of resources and competences, and explain the difficulties of Enron by pointing out the resources and/or competences that Enron lacked in order to be able to build a lasting competitive advantage in its diversification logic. Table 2 sets out the main lessons that can be drawn from the internal strategic diagnosis of Enron until 2002.

TABLE 2 - Strategic diagnosis of Enron
Phase 1
Physical resources: at a very early stage, Enron began to sell production capacities, which put it in an uncomfortable position, particularly in subsequent periods, and which was not always very coherent in terms of choice of location.
Phase 2
In the electricity trading field, holding production assets that can meet peak needs is one of the key factors for success. Enron instead opted for almost total outsourcing of its supplies, and gradually abandoned all its own production of electricity. Enron wanted to be present in distribution and in the trading of various capacities (gas, electricityb, water, telecoms, etc.) which cannot be managed in a similar global way. Enron did not have specific competences available for each of these “products”
Phase 3
In relation to a model of this type, “Enron, in its newer, market-based activities did not have an adequate base of experience to guide itself and did not have the necessary counterpoints in place.” More specifically, for the online trading activityc Enron developed insurance and risk hedging mechanisms, but did not necessarily have the competences, which could be provided in particular by financial institutions (insurers, banks).

In point of fact, Enron failed for several reasons. **First**, it moved too far away from its core business (unlinked diversification). **As** Enron progressively diversified its business portfolio, the company increased its failure risk because the goals pursued did not match the resources/competences that were available. As it has been put, “The requirements for a robust intellectual capital-based business model are quite simple. Intellectual capital is a resource-based view of the company and it is one that has the strategic perspective of the managers”. Given that there is a strategic consensus on what is to be achieved, the first question is: “Do we have the resources needed to do **it**? In Enron's case, in the early years, the answer was probably ‘no’”. **Furthermore**, Enron's failure stemmed from the fact that it considered trading as its core business and not as a business that was complementary to its traditional basic businesses. The principle was now not to own the production capacities.

Finally, its failure can be put down to its “going out of control, or indeed its bulimia” for new businesses without taking the time to “digest” the new units and consolidate them. **And** the corporate internal discourse accentuated **this euphoria**. **It** has been stressed the aggressive, extremist and imperialistic language used to describe the company as “Enron the Magnificent”. **While** Enron’s ethical charter promotes values such as respect, integrity, and excellence, “the only meaningful performance measure was the relentless pursuit of profit at any cost.”

Beyond “high-risk” accounting practices

Enron is not simply “a technical failure susceptible to a technical fix”. **Thus**, we are not addressing, in this paper, the question if these practices were fraudulent or high-risky, because **it** depends on the level of corruption and opportunism of corporate executives and accountants, those professionals who certainly did not receive sufficient lessons in ethics during their schooling and the contemporary accounting standards. In the case of Enron, accounting practices were misleading in spite of their compliance or almost with these rules.

Accounting had been reduced here to its technical aspects and the deception in the case of Enron was described to be made possible solely by “window dressing” or “cooking the books” practiced by some dishonest executive managers, a few “bad apples” who should be eradicated from the “holy” system to prevent future occurrences. In this paper, we will try to demonstrate that accounting is appealing our attention more for its role in the reproduction of a symbolic order and the maintaining of status quo. In reducing Enron affair to a technical question about how financial statements had been elaborated and audited, researchers and practitioners continue to ignore the most important side of accounting, namely its social, rhetorical and ideological essence.

Moreover, the trend to emphasize on technical and economic expertise when constructing a discourse about accounting is masking the substantially ethical nature of accounting. **It** is a form of obscuring the essentially moral nature of most accounting issues. A simple question is “where did all these bad apples learn to behave that way”? Therefore, the problem is deeper than the technical capacity of accounting to provide measurements about a business. The question is to know how accounting, by its own description, could be a part of a more global order and how it could displace attention from its real problems.

Sometimes you know that you cannot trust a number but for certain reasons you will use it to justify and legitimate your action. Accounting image was used in the case of Enron to legitimate what people wanted Enron to be and to reinforce their blindness. **Here** is what we can learn from the story of Enron: **In point of fact**, everyone either deliberately or unconsciously refused to see what was happening, in a sort of widespread myopia. Admittedly, the senior management actively exploited the shortcomings of the system to add to the complexity of their financial statements a system of obfuscation at two levels, by corrupting all authorities that were likely to reveal the risky accounting practices, and by manipulating the perceptions of the general public. **But**, no one wanted to take a critical view of this company, even people who were well-informed about its actual situation. Everyone had a desire to believe that the company was too good.

Besides the managed executive managers’ discourses, Enron set up a kind of opacity at all levels of control, thanks to the involvement of a large number of players, both financial and political, using money to suborn and influence their judgement, and the close links existing between the academic world and its directors, thus exploiting the weaknesses of the system. **For example**, Darden, Bodily and Bruner wrote the first Enron case study in 2000 entitled “The Transformation of Enron, 1986–2000”. This strategic case study was used by business schools, particularly in the U.S. In this case study, the authors stressed that Enron was a success story. **It** was not until 2002, after the company's misadventures that the authors brought the document up to date. **It** is now entitled: “Enron, 1986–2002: Critical Thinking about the Enron Story”.

Finally, widespread hypocrisy invariably arises in the type of Enron affair: “criticize, denounce, and consider a way of operating, values and practices as a release, when one would have quickly taken advantage of it, used it or abused it if there was a capital gain to be made”. Enron, long adulated as “leading the revolution” is now singled out as a paragon of dishonesty. Its directors, who were seen as the “messiahs of the new economy”, are dismissed as crooks. Its former supporters have today become its main detractors. Those who were the first to take advantage of the system are today the first to denounce **it**.

People were blinded by their greed and nobody cared about Enron delirium. Enron successfully presented itself as a company that was creating value and its shareholders accepted this image of Enron without asking themselves if these allegations were economically founded. **So**, much return was in game to be more critical and to consider what was beyond numbers, what kind of company was Enron. **It** was assimilated simply to a magic money machine. **Instead of** restraining them, Market professionals and corporate executives chose to feed the frenzy. **This** was the chronicle of an announced death.