What Every Indian Should Know About the Enron Story

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by *Sundar Sankaran*[*]
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Enron, the pipeline operater and power generater, which *tried to create a free market for energy, lost its energy and went for a free fall.* This has set in motion the third largest bankruptcy in US corporate history (assets US$25bn). The dubious frontrunners in the bankruptcy list are Texaco (1987; US$36bn) and Financial Corp. of America (1988; US$34bn). *Enron is dying. Long live the Enron spirit*.

Why am I praising the spirit of a bankrupt company? Despite its certain demise, there were a lot of positive things about Enron. This company, created out of the 1985 merger of Houston Natural Gas and InterNorth, was part of a traditional industry that is not known to be innovative. From such sober roots, *Enron went through a process of re-discovery and transformed itself into an aggressive trendsetter*.

Enron shook the dynamics of the energy sector through the free market that it sought to create. It even set out to create an until-then-unthinkable market for bandwidth. *It had the guts* to make a clean break from its past by choosing to sell off its pipeline and power assets to focus on its newer sectors of interest. No wonder Gary Hamel, the management guru was all praise for Enron in his book 'Leading the Revolution'.

What then went wrong? It broke the basic tenets of business prudence and business ethics-

Business prudence - balance your risk When you are experimenting with a new business model, do it with your own equity - not borrowed funds - and certainly not short term borrowings. In the case of Enron the risk profile was even higher because the funds were being invested significantly in intangible assets that would have no value if the business model failed. Yet it opted to fund these with short term borrowings.

Business ethics - ensure transparency When you are playing a high risk game, make it known to the people who deserve to be told - your stakeholders, including investors, lenders etc. Enron opted to present a rosy financial picture through a maze of off-balance-sheet funding without adequate disclosures to its stakeholders.

As can be expected in the United States, a flurry of legal suits has started involving Enron, its employees, Dynegy, lenders, investors etc. Some interesting aspects of the whole Enron episode are -

Speed of actions Dynegy took just a few weeks to decide on its proposed takeover of Enron. When Dynegy backed out, the company filed for bankruptcy within days. We can expect a quick sale of assets that can find takers and very soon Enron will be no more. *Note for Indian lobbies - There are no demands for the US government to nationalise Enron!*

Traders' sense Traders - counterparties for Enron trades - were the first to smell something fishy in Enron. This highlights the *need to have one's feet in the market, ears close to the ground but not fall asleep*!

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[*] Sundar Sankaran is Director, Advantage-India Consulting Private Limited

Regulatory patience Enquiries are on. But no one has jumped to any conclusions - despite Enron itself saying that its former chief financial officer Andrew Fastow, pocketed $30mn through the off-balance-sheet transactions. *Note for Central Bureau of Investigation (CBI)- The Federal Bureau of Investigation (FBI) is not raiding the residences of senior functionaries of Enron!*

Political maturity Enron chairman, Kenneth Lay is a close pal of US president, George Bush. Neither has the president tried to support his friend, nor are there any allegations of political conspiracy. *Note for Indian political parties - No one has asked for the resignation of Mr Bush!*

Investors' power Who brought down Enron? The investors. They were offended by the lack of transparency. They sold the shares upto a level where Enron had no option but to approach much smaller Dynegy for a bail out. *Note for Indian companies - Respect your investors. Note for Indian business groups - The Fortune 7 company had no qualms about approaching the Fortune 54 company with a sell-off.*

Keep the trades going Bankers have tried to ring fence the problem and bring in liquidity so that the trades in Enron's online market can continue. *Note for SEBI - There is no reflex action of shutting down trading terminals!*

Audit community pragmatism The big 6 of the audit profession have closed ranks. Rather than trying to score brownie points, they have come out with their view that Enron's disclosures were as per standards, but the standards themselves need to be reviewed in the light of changing structures of business.

But the Americans have not really covered themselves with glory. It was absolutely foolish to invest employee's retirement funds in the company's equity. Besides this, there are a number of questions that beg for answers. Were the credit rating agencies, Moody's, Standard & Poor's and Fitch, justified in holding the credit rating of Enron paper above investment grade, even though it was clear to the market that Enron paper had become junk? Did the statutory auditors compromise their position by taking up consulting assignments from Enron for rather juicy fees? To what extent were Enron advisers, JP Morgan Chase and Citigroup, independent in their advise to the company when a lot of their own money was at stake?

In the days to come some of these questions would get answered. A new set of standards for accounting, disclosures, roles and ethics will emerge. *Why does it take a disaster for standards to catch up with business reality?*