

E-Commerce in Enron

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BACKGROUND OF THE BUSINESS

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 USA. 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 in a wide range of products from pulp and paper to petrochemicals and plastics. It also traded in 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 pipe line 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. In 2000 the Fortune magazine named Enron as the most innovative company in the USA for the fifth year in succession. In the same year Energy Financial Group ranked Enron as the sixth largest energy company worldwide.

Enron's mergers brought the company much success, but Enron wanted more. Enron wanted growth which eventually led to its demise. 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 totally 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 just expanded into electric power generation and pipeline

capacity, broadband communication, and freight capacity of modular containers. All these were the factors that were responsible for Enron's growth and corporate greed led to its downfall (Ekbis, 2004).

DESCRIPTION OF THE BUSINESS

Prior to the Internet, the tools of trade were regular phones and fax machines. Computers were used but the Internet was still an untapped resource. With the new technology, information that took days to spread by newsletter and fax became available instantly. E-mail and instant messaging then made online trading the logical next step. Charles Moore, president of PetroVantage, said, "Rather than a threat to market stability, online services have made the industry more efficient by allowing companies to quickly analyze an offer and instantly run the decision tools to make a profitable transaction" (Jones, 2001, p. 3).

Meteoric Rise and Sudden Fall

Enron was a product of the information age. The basic premise behind Enron's strategy was to create markets for goods and services that were traditionally transacted through legacy distribution channels. Enron played three different roles at the same time as a broker, a trader, and a market maker. 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 risk management product to these buyers and sellers to make them comfortable with this new marketing exploit by hedging their financial exposures.

The introduction of EOL facilitated gas trading and operations. Enron was a large market participant, as both a buyer and seller of spot, fixed, and futures contracts. "Its launch quickly changed not just the firm but markets around the world", EOL was acclaimed by BBC News (2001). "Two years after its launch, the platform was averaging 6,000 transactions a day worth an average \$2.5 billion. Twenty-one hundred different financial products were on offer to traders, across four continents in 15 different currencies." Before the collapse of Enron the company was most certainly a success story. From 1985 to 1999 Enron's net income rose from \$125 million to \$893 million; its market value grew from 2 billion to \$50.5 billion (Enron, 2002).

Even though Enron had an advantage being a global market, offering customers an electronic option was not easy. They had to deal with a host of regulatory issues from one country to another. Data-protection laws as well as regulations vary from one country to another. Consequently, Enron had to develop different registration forms and to some degrees take a lowest-common-denominator approach. Also its competitors, like Aquila, Duke Energy, Dynegy, and The Williams Cos. wanted a share of the commodity trading market. The main problem now, given all Enron's challenges, was making success last.

Enron launched the New Power Company (NPC), the first national energy service in May 2000 along with its new strategic investors IBM and America Online. The NPC was created to provide energy services for residential and small businesses in the U.S., where deregulations in the energy market were introduced. 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.

Certainly, Enron exploited new areas of business in dynamic and innovative ways. Enron has had a major impact on the Internet trading industry. A competitor of Enron—Atlanta, Georgia-based IntercontinentalExchange—began discussing an IPO after seeing a surge of new business since Enron's collapse. And Enron's model, in which the company essentially served as the medium that backed every trade with a money-back guarantee—likely will live on as well, according to Forrester Research analyst James Walker. In a report, Forrester's Walker explained the somewhat ironic reason for Enron's previous success in this way: "Enron exploded online by managing risk better than others" (Regan, 2002).

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). 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. Fierce internal competition prevailed. Paranoia flourished and contracts began to contain highly restrictive confidentiality clauses.

Hypothetically, the introduction of EOL could have increased the competitive functioning of the gas markets, or instead it could become a vehicle for increasing the concentration of market information in the hands of the Enron traders. Aided by the information available through EOL, Enron could emerge as a dominant firm exerting influence on the market to its own advantage (Murry & Zhu, 2004).

With the use of e-commerce and the acceptance of its countless benefits come responsibilities and risks if not met. Enron began diversifying its portfolio through the use of thousands of special purpose entities (SPEs) which allowed the company to embark upon less conventional ventures without necessarily reflecting their cost on its

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