

Good the rise and fall of enron research paper example

[Business](#), [Company](#)



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Introduction

History of Enron is a story that started very well. It was a real business with a tremendous reputation. It had created a market for trading. The best people worked there. Enron Corporation was a giant of American energy industry. Prior to its bankruptcy December 2, 2001, Enron had about 22 000 employees and was one of the world's important manufacturer of electricity, natural gas, communications, and the owner of the pulp and paper companies, with revenues of nearly \$101 billion in 2000. In general, who does not hear about Enron? It is the most scandalous president deception with huge number of shareholders in the United States. Fortune awarded Enron the title of the Most Innovative Company of America for six consecutive years. In late 2001 it was revealed that its financial condition, which reportedly was completely bogus, simply systematic and creatively

planned accounting fraud, known as “ Enron scandal”. Enron has since become a popular symbol of deliberate corporate fraud and corruption.

The Beginning of Enron

Enron was founded in 1985 by the merger of two companies, Internorth and Houston Natural Gas. Production of energy was its initial field of activity. In 1990, about 80% (\$11 billion) revenue was received from the management of gas networks and pipelines. In 1990 top managers, who have taken a decision on realigning the business, came to the company. Enron began to actively engage in energy trading. Once its president, Jeffrey Skilling, said that the success of the company lied in the liberation of the “ hard” assets, as they brought cash, which can be scrolled with the more profitable trading activities. So Enron gradually turned into a trading company, which was to do everything that somehow was connected with the energy market, namely from contracts for the supply of electricity to traffic in high-speed networks for transfer of large amounts of data (Moncarz Elisa S., Moncarz Raul, Cabello Alejandra and Moncarz Benjamin, 2006).

An important tool for the implementation of the new strategy was the first in the energy sector the commercial Internet portal Enron Online, called by analysts as the most successful commercial project in the network. 20% of all transactions in the energy sector in Europe and the United States were carried out through the site. Thus, the company has become a leading power broker in the US market. Some analysts considered Enron as the company had no more be the energy trader, becoming a speculative financial company with a gas pipe on the side.

A radical realigning brought brilliant results. In the most successful 2000, the company's revenues increased by 2.5 times compared with the previous year, reaching \$100 billion. And in four years (from 1996), operating income increased from \$500 million to \$1.3 billion. The average annual growth rate of Enron accounted for 57%.

Having the number of employees of 19 thousand people, gross income comes to one employee, was \$5.3 million (2000). This was three times greater than Goldman Sachs, eight - than at Microsoft, eleven - than at Citigroup than nineteen than IBM. It only remains to add that 95% of its revenues and 80% of operating profit in 2000 brought the energy trading and providing various services in this market (Moncarz Elisa S., Moncarz Raul, Cabello Alejandra and Moncarz Benjamin, 2006).

As a corporation on a national scale, it could not be away from politics. It had extensive connections in political circles, especially in the Republican Party. It is worth to say that Enron's president Kenneth Lay was considered a personal friend of George W. Bush. Not surprisingly, the company received an unprecedented share of the public electricity supply, and large tax breaks. In addition, it was its final say in the selection of persons responsible for the regulation of the energy market.

Problems of Enron

When investors were happy and counted space profit and experts talked about incredibly successful business with admiration by the Enron's leadership, something that was least expected happened: the bubble burst. The thunder appeared in October 2001, after the publication of the

company's financial statements for Q3. Against the background of the visible (as it turned out) successful trading very few people were bothered by the lack of transparency in company's actions. Initially, gradual decline (since early 2001) in the value of Enron's shares from \$80 in January to \$36 in October did not cause any problems. But when it became aware of the fatal problems concern of investors has increased dramatically (Enron: Corporate Failure, Market Success, 2002).

Enron officially named a huge amount of contingencies. According to CEO Kenneth Lay, there was a reduction of capital by \$1.2 billion. The reason is the failure of foreign investment partnerships, supervised by top manager Andy Fastow. In addition, unexpectedly it was revealed that Enron had a lot of off-balance sheet transactions. It also allowed gross violations taking into account transaction costs, by all means trying to inflate them.

Suddenly formed "black hole" in the budget instantly reflected on the mood of the players of the stock market. Leading rating agencies downgraded Enron's credit rating to the lowest, the so-called junk level, resulting in the value of its shares fell by 85%. November 1 The Securities and Exchange Commission (SEC) launched an investigation into the financial activities of Enron.

Merging giant with its relatively small rival Dynegy Inc. was to prevent the collapse. According to the initial agreement, Dynegy was intended to provide \$22 billion, out of which \$13 billion were aimed at repayment of Enron's debt, the remaining \$9 billion were direct payment for the company. As an emergency measure the competitor proposed financing \$1.5 billion, demanding guarantees on the use of the gas pipeline of Enron Northern

Natural Gas. After the fall of Enron quotations on exchanges and detection of previously unrecorded debt of the company Dynegy first demanded renegotiation of the deal November 29 and refused to buy at all (Oppel Jr. Richard A. and Sorkin Andrew Ross, 2001).

These developments meant for Enron the end. December 2, 2001 the company became the largest corporate bankruptcy. Earlier sad championship belonged to another representative of American business – Texaco Inc., bankrupt in 1987. Even in poor condition, Enron's management did not fail to “prick” failed partners, filing a claim in the amount of \$10 billion, accusing Dynegy of deliberately disrupting the transaction in order to eliminate a competitor (Oppel Jr. Richard A. and Sorkin Andrew Ross, 2001). Even though a positive judgment is unlikely to save the energy giant – for the year Enron's market capitalization has fallen from \$220 billion to \$80 million at the share price of 26 cents. At the same time, the company's debt had soared to \$16.8 billion, and in December the amount of debt has reached \$31 billion. At the beginning of January 2002 NYSE announced the cessation of trading in the shares of Power Corporation.

Reasons

The official reason for the suspension of trading on the NYSE was waiting for important news. Indeed, soon the news agencies spread not one, but several important news about Enron. The crucial among them was the message from the US Department of Justice to open a criminal case related to the bankruptcy of the company. Up to this point the investigation was conducted by only Securities Commission, which is intended to verify the nature of

partnerships, involving Enron. However, suspecting the top managers in the concealment of financial liabilities of the energy giant, state agencies attracted to the investigation a number of agencies, namely the Federal Commission on Securities and Exchange Commission, the Ministry of Justice, Congress and the FBI (Enron: Corporate Failure, Market Success, 2002).

During the investigation it became clear that the part of Enron reporting disappeared without a trace. Chairman of the Committee of the US House Energy Billy Tauzin, in turn, said that the finding destroying financial documents caused serious concern and the investigation is required.

Investigators were interested primarily in activities of representatives of senior management. One of the Enron's top managers – Vice President of Development – did not wait for the charges and committed suicide. Kenneth Lay also lost his CEO position, after a memo was found at his place, in which he warned about the collapse of the company. In his farewell speech, the former president of Enron said that in order the company survived at the helm there should be a person, who is capable 100% of its efforts focus on its reorganization.

For four years, during which the proceedings for Enron's bankruptcy continued, investigators have found startling facts. As it turned out, the company has built a network of partner institutions, which enabled it to hide from external observers multimillion-dollar debts. Moreover, millions of dollars illegally were transferred to the accounts of Enron's top managers, their families and friends, as well as to their close companies. No less disastrous was the fact that some members of senior management, taking advantage of inside information, dropped unreliable shares of their company

before they fall on the stock exchange (Moncarz Elisa S., Moncarz Raul, Cabello Alejandra and Moncarz Benjamin, 2006).

Another surprising finding by the investigators was the role in this scandal of Enron's partner – Arthur Andersen company, which was part of the big five accounting firms. Activities of reputable company had the particular interest on the part of the investigation, as Andersen auditors approved the financial statements of Enron. Recent suspicion of concealing by auditors the real situation vanished after the fact of mass destruction by Andersen staff of the documentation related to the energy giant surfaced. Experts almost unanimously expressed the view that, knowing about the illegal actions of Partner, Head of the audit company decided not to give them public because they do not want to lose a profitable customer (only in 2000, Enron paid for audit services \$50 million). At a meeting of the investigation team of the US Congress the phrase that Enron robbed a bank, Andersen provided the machine on which the robbers could escape was voiced.

As a result of the scandal, both companies – as the culprit and its audience – ceased to exist, in part going to the nearest competitor. Centrica company, for example, acquired European division of Enron, engaged in retail trade for GBP 96, 4 million, and Dynegy gained pipeline in the United States.

Top managers of Enron were sentenced to various terms. And the main accused, the head of Enron, Kenneth Lay, as already noted, has died of a heart attack at his home in Colorado, July 5, 2006, without waiting for the verdict.

Consequences of Enron Bankruptcy

Enron bankruptcy has caused irreversible effects in the US economy:

1. All 22 thousand Enron employees suddenly become unemployed. Most of them also invested in the Pension Fund, reinvested 60% of the funds. As a result of the collapse the loss of ordinary employees, who used this pension scheme, amounted to hundreds of thousands of dollars.
2. Former Enron partners faced with financial problems. Many banks have not been able to fully recover loans and investments (JP Morgan at different times invested \$900 million, Citigroup - \$800 million).
3. The scandal has caused a crisis of confidence in the audit services. The first of these sentiments were recorded by experts from Transparency International. Some of the major clients of Arthur Andersen decided to stop cooperating with it.
4. As a result of an investigation of Enron's case AOL Time Warner, WorldCom, Tyco, Cisco Systems come under suspicion of investigative bodies.
5. Business Week Observers announced about the critical fall in investor confidence in the US economy.
6. The case of Enron prompted a major reorganization of the corporate business and the establishment of state control over the corporation. In 2002, the US Congress passed a law requiring all companies to do audits transparent to investors. Also Sarbanes-Oxley Act was adopted, providing for tougher sanctions for violation of the laws governing the stock market. Top managers of companies that have previously applied the incorrect statements were obliged to return all bonuses and gains from shares

received in the last 12 months.

7. Companies were forbidden to lend money to their leaders. Also, top managers must confirm in writing that the statements of their companies prepared in accordance with applicable rules and reflects the real state of affairs.

Conclusion

The first place among the causes of the crisis and the collapse of the company belonged to the absence of an effective system of internal and external control, as well as the contradiction between the interests of senior executives receiving compensation as a percentage of the displayed accounting profit and the interests of the corporation as a whole. This conflict of interest made the management of the company to hide losses and inflate profits. Among the victims of the collapse of the company are investors, holders of securities of the Company and employees of the company.

Therefore, the main thing is that the more transparent the company, the better the market understands what it takes, the more difficult it is to steal. Another important fact is that a modern business is a complex work and very difficult profession.

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