

# THE SCANDALOUS FALL OF ENRON

## A Call for Ethical Re-positioning in Business

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### 1. Introduction

Business is an art as well as a science. As an art it needs deep concentration and dedication. Its scientific nature demands logic and orderliness. Healthy synthesis of these factors in a harmonious way is very essential for the success of any business. The example of Enron, however, projects a reverse order, that is, it tends to showcase how malpractices can create an apparent boom in business and veil it with fabricated excellence. Such tendencies produce only short-lived bubbles of prestige in business and in society. They are actually deviations from the right track. In such a context, I suggest an ethical re-positioning in business, that is, we have to re-assert the values which enhance business and the well being of society. The relevance of this re-assertion of values is explained here with the example of the scandalous fall of Enron. Though its fall took place a couple of years ago, its ethical implications are still significant for analyses.

### 2. Fabricated Excellence and Collapse of Enron

Enron was one of the prestigious power corporations in the US. The global energy market was highly influenced by Enron because they explored the possibilities of energy trade and was regarded as a market leader.<sup>1</sup> The name and fame of Enron did not last long because of various reasons. According to Nick Beams, "the primary cause of Enron's risky behaviour was the growing arrogance of its executives who became confident that no

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<sup>1</sup>Beams, "The Enron Collapse and the Crisis of the Profit System" [Online]: <http://www.wsws.org/articles/2002/jan2002/enro-j29.shtml>

one was looking over their shoulders, watching and understanding what they were doing."<sup>2</sup> The fall of Enron is not only a fall of a company but also fall of a system. The auditors, Arthur Andersen Group, torpedoed the system of accounting through illicit entry of accounts. It is said that to shoot up the profit of the corporation, at the instructions of its executives, they entered the revenue expenditures, instead of entering them in profit and loss accounts, into the balance sheet and showed as capital expenditure. As a result the exaggerated profit of Enron seduced the shareholders and other stakeholders, and people madly owned the shares of Enron as a sign of cachet in society.<sup>3</sup>

Reality, however, was too far from this manipulated business boom. According to Christy Sanders,

In a successful attempt to hide their large debts, the company established a series of limited partnerships, which could be treated as separate entities. These accounting tricks had the desired effect of showing the company's profit to be much higher than they actually were, pushing up stock prices, deceiving investors and lying to Enron's own employees, encouraging them to sink their savings and retirement funds into company stock. The company itself made payments to these pension funds in stock rather than cash.<sup>4</sup>

The investigation reports prepared following the fall of Enron were somewhat glossy. Andrew S. Fastow, company's Chief Financial Officer (CFO), was the driving force behind the adoption of the foul accounting decision. The company was transformed into a partnership firm of four persons and the CFO became one among the partners. According to Kurt Eichenwald, "these four entities were purportedly established to give Enron the ability to hedge certain of its investments; under the concept, as

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<sup>2</sup>Beams, "The Enron Collapse and the Crisis" [Online].

<sup>3</sup>Shareholders are the people who contribute to the capital of the company at different times and receive a portion of ownership in the form of shares in accordance with their contributions. Stakeholders are the people who are closely related to business either as shareholders or as the people who are necessary for the success of business in different forms. Employees, government, industry, consumers, international community, etc., are some of the examples of stakeholders.

<sup>4</sup>Sanders, "Enron Collapse Exposes Extensive Corruption and a Massive Political Scandal" [Online]: [http://www.moles.org/project\\_underground/drillbis/7\\_10/3.html](http://www.moles.org/project_underground/drillbis/7_10/3.html)

the value of the investments went down, the values of the Raports (a quartet of partnership) would go up, and vice versa.”<sup>5</sup> Ideally, the CFO could not become a partner of the same firm because he was bound to protect the rights and privileges of shareholders and other stakeholders without any partiality. Here this principle was violated. As a partner, the CFO longed for the share of profit and failed to faithfully execute the service which he ought to have performed.

While concealing its debt from others, Enron had projected a false graph of profit to shareholders and other stakeholders.<sup>6</sup> Andersen, the auditors, earned more from Enron for non-audit services (\$72 m) than it did for auditing (\$25 m).<sup>7</sup> Enron’s internal audit committees (a subset of their board) failed to police their auditors properly.<sup>8</sup> In short, the accounting manipulations gave the message to the general public that the company was growing fast and as a result its share value went up. When this foul play was noticed the company fell down from the top, resulting in an economic crisis in the US economy for a short period of time. The US government was also not an innocent victim of the malpractices of Enron. Government officials also played their part with vested interests.

### 3. The Role of Government in the Fall of Enron

It is quite unfortunate to note the role of a government, unduly supporting and safeguarding the malpractices of a business organization. Financial experts have opined that Enron’s fall started from the former US President Bill Clinton’s administration itself. Clinton had a soft corner towards Enron and its business. Charles R. Smith noted that “in 1992, Enron donated \$100,000 to Clinton’s inauguration, and Enron’s top executive Ken Lay stayed at the White House 11 times.”<sup>9</sup> Further, according to Smith, Clinton government rendered many favours to Enron officially,

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<sup>5</sup>Eichenwald, “Andersen Trial Yields Evidences in Enron’s Fall” [Online]: [http://www.money.cnn.com/2002/06/17/news/companies/andersen\\_followup/index.com](http://www.money.cnn.com/2002/06/17/news/companies/andersen_followup/index.com)

<sup>6</sup>“The Ship That Sank Quietly” *The Economist*, February 16-22, 2002, 56.

<sup>7</sup>“When the Numbers Don’t Add Up,” *The Economist*, February 9-15, 2002, 61.

<sup>8</sup>“When the Numbers Don’t Add Up,” 62.

<sup>9</sup>Smith, “The Real Enron Scandal” [Online]: <http://www.newsmax.com/archives/articles/2001/1/28/155951.shtml>

including contacting foreign countries for Enron. The executives of Enron travelled with the US officials all over the world, especially through Russia, India, Indonesia and China, for business campaign. By exploiting the political influence the US authorities, for example, forced Indonesia to sign business contracts with Enron. East Java Power Project was one of such deals.<sup>10</sup> The documents show that the Clinton administration knew about the deals which were also filled with kickbacks for Indonesian President Suharto.<sup>11</sup>

It is believed that the US government knew the corrupted behaviour of Enron but did nothing to prevent it because of political and monetary gains. Ideally, a government must act as the watchdog of the wellbeing of the society but here the Clinton administration miserably failed to fulfil its obligations. Smith has noted that Enron collected a good amount of money from Exim, Export-Import, Bank and the US Department of Transportation through a corrupt manner by using their influence in government. Their political influence motivated them to behave in such way and it fuelled the company to cheat the general public without any pricks of conscience. Charles R. Smith notes:

Documents obtained from the Clinton administration are filled with direct quotes and hard numbers detailing taxpayer money that were paid as illegal bribes to a corrupt regime. The citizens of Indonesia and the United States were the victims of a massive crime. That crime has received no press attention and no investigation.<sup>12</sup>

It is not befitting to blame Clinton administration alone for the corruption and fall of Enron. George W. Bush is also responsible for its fall. Christy Sanders reveals Bush's contact with Enron and for that the author quotes Centre for Public Integrity and says: "... George W. Bush had received a total of US\$ 774,100 in campaign funds from Enron management (including US\$ 312,500 for gubernatorial campaigns), making this company the single largest patron of his political career."<sup>13</sup>

It is said that Enron had played a vital role in the formulation of government's power policy. The power policy was drafted by a task force

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<sup>10</sup>Smith, "The Real Enron Scandal" [Online].

<sup>11</sup>Smith, "The Real Enron Scandal" [Online].

<sup>12</sup>Smith, "The Real Enron Scandal" [Online].

<sup>13</sup>Sanders, "Enron Collapse Exposes Extensive Corruption" [Online].

and Enron had made a discussion with this group. It is said that the final draft of the policy was formulated in accordance with the interests of Enron. After the crisis came to public notice, the General Accounting Office (GAO) conducted an enquiry on the influence of Enron over the formulation of the power policy. GAO had asked for the report of the task force from the US Vice-President Dick Cheney, and to investigate the malpractices which took place in it. The Report blames that even after nine months Cheney did not present it before GAO. Instead, he justified his deed by saying that the President and Vice-President can solicit advice from anybody they want in confidence. Christy Sanders reports on this situation:

It is known that Enron had six meetings with the Task Force, and that Kenneth Lay was given a private meeting with Cheney one month before the final policy was released. Democrats, environmental and human rights groups, and concerned citizens are now asking how much influence Enron was given in the formulation of the policy and why such a task force did not allow equal participation by other interest groups.<sup>14</sup>

The GAO announced on January 30, 2002 that it would file an unprecedented suit against the White House to get the information it has requested.<sup>15</sup> These incidents clearly show the role of the US government in the corruption of Enron. It is said that majority of the senators and congress members, serving on the committees set up to investigate the issues related to the Enron demise received campaign contributions either from Enron or from Arthur Andersen.<sup>16</sup> These factors are not healthy in any society and in business. The need of business ethics comes here and one has to follow the basic codes and norms of it to ensure a bright future; otherwise, 'Enrons' would be repeated.

#### **4. The Immediate Effects of the Fall**

The fall of Enron can be seen as a heavy blow on the shareholders and other stakeholders because they were forced to bear the brunt of this scandalous treachery. In fact, the fall of Enron heavily damaged the

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<sup>14</sup>Sanders, "Enron Collapse Exposes Extensive Corruption" [Online].

<sup>15</sup>Sanders, "Enron Collapse Exposes Extensive Corruption" [Online].

<sup>16</sup>Sanders, "Enron Collapse Exposes Extensive Corruption" [Online].

boomed aspirations of shareholders and other stakeholders. Enron was created in 1985 and from the starting point onwards it had a swift growth and many wondered at its advancements and influences in the field of energy.

Initially, the share value peaked at US\$ 90 per share and many longed for it as a mark of power and prestige. When the malpractices were detected by the end of 2001, the share value slumped just to US\$ 5 per share.<sup>17</sup> Those who had invested their savings in the shares of Enron miserably collapsed with Enron. Employees lost their jobs and retirement benefits which were in the form of company's stock. They were also misled by their own employers and it expedited the intensity of their disappointment.<sup>18</sup> Though the government fed Enron with undue influences, the fall unravelled all sorts of their illicit relationship to the general public. The government was supposed to be the watchdog of the well being of society but, unfortunately, it operated under the clutches of multinational business giants. This was really an unfortunate phenomenon. In the broader sense it caused even existential crisis and a kind of distrust among people. It heavily damaged other industries of the same category. According to W. J. Billy Tauzin, "the stock values of companies involved in energy trading, and in the construction of independent power plants, have fallen significantly in the wake of the Enron bankruptcy."<sup>19</sup>

The fall of share value indicates that such companies lost their credibility, as Enron has set a bad example before them. The fall adversely affected the consumers also because all on a sudden, as suppliers of various services disappeared from market without prior notification. The regularity of their operations broke down and the concerned businesses were frozen for a short period of time. Tangible and intangible losses steeped up and took a lot of time for recovery. International community also was shocked with the fall of Enron because the latter had a world

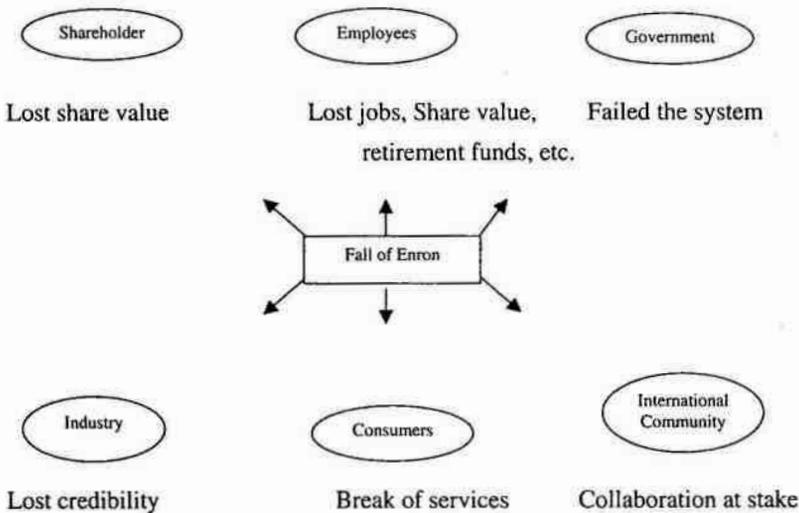
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<sup>17</sup>Sanders, "Enron Collapse Exposes Extensive Corruption" [Online].

<sup>18</sup>Jeffrey Gordon, "What Enron Mean for the Management and Control of the Modern Business Corporation: Some Initial Reflections," *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance*, ed. Thomas Clarke, 322-332, New York: Routledge, 2004, 328-30.

<sup>19</sup>Tauzin, "The Effect of the Bankruptcy of Enron on the Functioning of Energy Markets" [Online]: [http://www.energycommerce.whitehouse.gov/107/hearings/0213200hearing487/the-honorable\\_joe-Bartonprint.com](http://www.energycommerce.whitehouse.gov/107/hearings/0213200hearing487/the-honorable_joe-Bartonprint.com)

wide web of business and those business mansions disappeared from the scene with heavy damages to its stakeholders. Effects which fell upon them are almost the same when compared to other industries, but the intensity varies in accordance with the involvement of both parties in business. In brief, the consequences of the fall of Enron are regrettable and indicate that we need credibility and sustainability in business.



### Effects of the Fall of Enron Upon Shareholders and Other Stakeholders

#### 5. Significance of Ethical Re-positioning in Business

The fall of Enron was really unfortunate but at the same time it shed light on the loopholes of the present accounting system in the US. Earlier, Harshad Mehta, an Indian Share-broker, did commit malpractices in Indian share market and had unravelled the possibilities of foul play in this field. Both these instances alerted the authorities and were forced to tighten the rules and regulations with regard to it. What we need is creative exposition of possibilities with maximum output. The greedy rise of Enron has really shaken the ethical world and communicated a bad example which is veiled

under the principle of excellence. Such practices would certainly influence other companies in many respects and as a result they may follow the same pseudo-principles in order to flourish in business. Such tendencies, however, may harm shareholders' and other stakeholders' interests with heavy blows as Enron did. In other words, here the most fundamental principle of ethics, that is, justice is at stake. So, an ethical re-positioning becomes an inevitable and a significant need.

### 5.1. Refined Notion of Justice

It is interesting to note the analysis of justice and its applications in business, especially in connection with the fall of Enron. Scholars define justice in different ways. *The Republic*, the celebrated work of Plato, gives the message that justice is giving the due of the other.<sup>20</sup> Aristotle, in his *Nicomachean Ethics*, places justice as the greatest of all virtues and for him justice is to be distributed according to the worth of the individuals.<sup>21</sup> Thomas Aquinas defines justice in his famous work *Summa Theologiae*. For him, justice is the habit whereby a person with a lasting and constant will renders to each his/her due.<sup>22</sup> John Rawls, placing justice on top of all virtues,<sup>23</sup> speaks of its two aspects. These include, first, equal distribution of rights and duties of individual and, second, social and economic inequalities as well.

At the initial situation of moral life all are situated at equal position because nobody will be less or more advantageous over the other. From this ideal ground human beings choose the principle of justice. Once people step into it, each one can advance himself/herself according to his/her talents. Social and economic inequalities would result in society according to the growth and it is inevitable for the advancement of society. Rawls would say that such advancement has to uphold the least advantaged in society so that the wellbeing of the community will be

<sup>20</sup>Plato, *The Republic*, I.333-354, ed., G. R. F. Ferrari and trans. Tom Griffith, Cambridge: Cambridge University Press, 2000.

<sup>21</sup>Aristotle, *Nicomachean Ethics*, V.1131a22, trans. David Ross, New York: Oxford University Press, 1925, reprint edition 1984.

<sup>22</sup>Aquinas, *Summa Theologiae*, 2a2ae.58.1, trans. Thomas Gilby, Cambridge: Blackfriars, 1975.

<sup>23</sup>Rawls, *A Theory of Justice*, Cambridge: The Belknap Press of Harvard University Press, 1971, 3.

maintained appropriately.<sup>24</sup> Today, however, most of the people are not bothered about the least privileged and do practically nothing for their advancement in society. The executives of Enron even did not care for its shareholders and other stakeholders. Moreover, Enron doctored amazing profits at the cost of shareholders and other stakeholders.<sup>25</sup> Rawlsian ethics does not consider a person and his/her activities as a single unit. It holds that one can personally excel without considering the ethics of his activities, but it may lead to a total collapse. Rawlsian notion, therefore, is also not a foolproof principle of justice.

So Justice, in fact, is more than these definitions. The refined notion of justice which I propose is: justice ought to embrace the other in his/her totality to pave the way for his/her integral and balanced establishment with empirical and transcendental orientations. Justice is not just a habit or giving the due of the other or distributing anything according to the worth of individuals. In the strict sense, I think, these notions of justice guarantee only the rights of individuals. The primacy of justice among the virtues is universally accepted.<sup>26</sup> The refined notion of justice would hold that the other must be taken in his/her totality. Then, his/her empirical as well as transcendental nature is to be acknowledged well and by footing on this ground we have to pave the way for his/her integral and balanced establishment so that he/she too can do the same to the other without any reservation. That is, though human person is a finite being he/she can move towards infinite possibilities, and this intertwining nature keeps him/her at the peak of ethical web of beings as the ambassador of the ultimate norm designer. Here, especially, rational beings would get a prominent place among other beings with the mission of implementing the above principle of justice in its full sense. As a result the standard of the society will go up and social wellbeing will become a concrete reality. The principles of the refined notion of justice have to be operational among all as a single unit for their fruitful functioning in the life of individuals and society.

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<sup>24</sup>Rawls, *A Theory of Justice*, 15.

<sup>25</sup>Gordon, "What Enron Means for the Management," 326.

<sup>26</sup>Here, in this refined notion of justice, I am indebted to both Aristotle and John Rawls.

## 6. Raising Standards in Business and Ethical Re-positioning

A wise man is a person who learns good lessons from the past and implements it in the present for a prosperous future. The scandalous fall of Enron shook the ethical world and as a result ethical principles were tightened with the view to block such catastrophes which may shrink the sustainability of business. Business has to be built upon the principle of justice. Justice has got a wider meaning, and its perspectives encompass the human person and his/her activities in their totality so that the implied meanings would become more realistic through his/her concrete acts of convictions. In the beginning he/she grounds in the actual situation and then starts his/her journey towards unlimited possibilities in order to explore greater heights for the benefit of his/her fellow human beings. While analyzing the problems connected to the case of Enron, one finds that they started from the ground realities and expanded their wings towards the horizons of innumerable possibilities. Till this stage they were on the right track. During their journey towards the peak of business expansion deviation from the right track took place and they misused the opportunities which were present for the nourishment of business as well as the wellbeing of society. Here started their ethical decline and had gradually lost their grip to crumble down miserably. These instances demand an ethical re-positioning in business.

Ethical re-positioning means a shifting from the existing ethical principles, which are proved inefficacious to ensure the wellbeing of individual and society, and to embrace the principle/principles which enhance individual as well as social wellbeing at different circumstances. Here I propose an ethical re-positioning because none of the existing ethical principles safeguards the interests of shareholders and other stakeholders. The refined notion of justice seems to serve the purpose. The three principles, which constitute the refined notion of justice, would envelop both individual and his/her overall activities.

The first principle, embracing the other in his/her totality includes the person and his/her activities. Personal ethical choices and ethical choices of his/her activities (e.g., Business) are involved here. Both these things are to be considered as a single unit in the realm of ethics. Here one can avoid ethical clashes because he/she is not looking for an ethics for particular activities. All his/her activities are taken synchronically in his/her moral behaviour. For example, when a person enters software

market, first of all he/she should be a trustworthy person; otherwise people will not initiate a contract with him/her. Secondly, the business must also contain truthfulness and fidelity and it would lead to real success. Ethical relativism will not work here, that is, an ethics for personal life and another for business. A human person is a complex being and all his/her activities are intertwined and no watertight compartmentalized operation is possible. If such things happen, then, people would brand it as duplicity in behaviour or multiple personality, and declare him/her unworthy to collaborate.

Second, this principle would pave the way for his/her integral and balanced establishment. This is the outflow of the first principle because the person and the activities operate as a single unit and if they are on the right track, naturally they would proceed to integral and balanced establishment. Here the person strives for a single goal and he/she concentrates all his/her energy to realize this goal. Such integral operations set good models in society.

Third, empirical and transcendental orientations must be considered gently because a sense of satisfaction needs material and immaterial elements. Human person is material and spiritual at the same time and so also his activities. For example, any business needs profit and sustainability for its success. For this the values such as truthfulness, fidelity, etc., have to collaborate with justice. These three principles are not three isolated entities rather one operating principle in the case of individual and of his/her activities.

The executives of Enron failed in their moral behaviour, because they separated ethics of individual and business as two distinct entities. At the initial stage the executives tried to project prosperity but they could not succeed in it. Individual and business had their own goals and the officials of Enron did nothing to integrate them for the sustainability of business. Ideally, the governing body of the business is supposed to enhance the interests of shareholders and other stakeholders. But it is not taking place properly in present day's diverse contexts. So, we go for new equations in ethics. This is the reason why I suggest an ethical re-positioning in business, which may ensure the harmonious existence of humankind.

## 7. Conclusion

The history of world business has recorded diverse sorts of examples and their after effects, for the future analysis of the existing as well as forthcoming business persons. History of the rise and fall of Enron sheds light upon the craze of executives who longed only for profit and their conscious ignorance of the welfare of shareholders and other stakeholders. In other words, Enron unveils the facts of deviation from the right track of ethical behaviour. This is not an isolated incident; many follow the same track for the realization of selfish motives. So, to have the ethical rhythm of society maintained we have to initiate an ethical re-positioning, that is, upholding the principle of justice and other good values. It would furnish the society with ideals for a bright future. We have to cater to these ideals among our fellow members of society for cultivating refined behaviour and meaningful existence in every field in which a human person involves. This is to be the fundamental quest of every business and of human person.