

1 WHY DID ENRON FAIL?

2 an interaction of forces external to and internal to the firm

3 EXTERNAL

4 market transformation was too slow and too narrow

5 INTERNAL

6 management focused on tactical results in a strategic game

7 accounting slight of hand

8 principal - agent problem

9

10 <http://www.enron.com/corp/investors/annuals/2000/ar2000.pdf>

11 page 48, footnote 16: Related Parties Transactions

12 page 51, footnote 20: Geographic and Business Segment Information

13 REVENUES

14 \$ 3.0B Transportation and Distribution

15 \$95.9B Wholesale Services (derivatives)

16 \$ 4.6B Retail Energy Services

17 \$ 0.4B Broadband

18 (\$2.1B) Corporate and Other

19 \$100.8B TOTAL

20 misstatement of income around \$0.7B (but used \$0.001 for rounding)

21

22 WHAT IS THE CONTEXT OF THE FAILURE?

23 Theory of the Firm versus the Market

24 most efficient location of transactions

25 Minimum Efficient Size

26 Justifications for profit

27 NORMAL: attract & keep entrepreneurial ability versus risk premium

28 ECONOMIC: reward to innovator versus monopoly power

29 Risk management: aversion neutral seeker

30 Derivatives versus "real" products

31 relative contribution of subjective factors as inputs

32 counter party creditworthiness

33 "run on the bank"

34 Industry structure

35 natural gas

36 well head versus pipeline; spot versus firm

37 broadband

38 dark fiber versus content

39 electricity

40 generation versus transmission versus distribution

41 spot versus firm

42 regulated versus "deregulated"

43

43 Enron failure is a function of Greed, Irony, Hubris, and Fraud.

44 **E = f (Fr, G, H, Ir,)**

45 **G = f (D, Ac, N, Jd)**

46 **Ir = f (Kn, In, C, Am, Im)**

47 **H = f (P, Ar, Js)**

48 **Fr = f (Kn, In, Mi, Ma, Fa, Jr, R, Ij)**

49

50

51 **G = f (D, Ac, N, Jd)**

52 where $G > 0$ if either $D * Ac > N$ or $D * Ac > Jd$

53 but where $N < = > Jd$

54

55 Greed is a function of desire to acquire in excess of one's needs or just desserts.

56

57

58 **Ir = f (Kn, In, C, Am, Im)**

59

60 Irony exists when words or numbers are used to deliberately contrast between
61 apparent meanings and intended meanings.

62

63

64 **H = f (P, Ar, Js)**

65 where $H > 0$ if either $P > Js$ or $Ar > Js$

66 Hubris is pride and/or arrogance in excess of an objectively justifiable self-image.

67

68

69 **Fr = f (Kn, In, Mi, Ma, Fa, Jr, R, Ij)**

70 Fraud exists when the defendant knowingly and intentionally misrepresents a material
71 fact inducing the plaintiff's justifiable reliance and causes the plaintiff's injury.

72

73 LIST OF VARIABLES

74

75 **Ac = Acquire**

76 **Am = Apparent meaning**

77 **Ar = Arrogance**

78 **C = Contrast**

79 **D = Desire**

80 **E = Enron failure**

81 **Fa = Fact**

82 **Fr = Fraud**

83 **G = Greed**

84 **H = Hubris**

85 **Ij = Injury**

86 **Im = Intended meaning**

87 **In = Intentional**

88 **Ir = Irony**

89 **Jd = Just desserts**

90 **Jr = Justifiable (reliance)**

91 **Js = Justified self image**

92 **Kn = Knowing**

93 **Ma = Material**

94 **Mi = Misrepresentation**

95 **N = Need**

96 **P = Pride**

97 **R = Reliance**