

Corporate Aftershock, The Public Policy Lessons from the Collapse of Enron and other Major Corporations

By: Culp and Niskanen

Summary by Dan Wouden

Enron did not fail because it was engaged in commercial and merchant commodity businesses nor did it fail because it used complicated financial contracts.

Culp and Niskanen argue that Enron failed since it never identified its true comparative advantage. Competitive markets are effective judges of successes and failures. Enron was successful since it ran an asset lite strategy.

I feel like this is one of the best descriptions of Hayeks paper, The Use of Knowledge in Society.

“In the neo-Austrian or disequilibrium-oriented context, by contrast, the market is viewed as a process that is in a constant state of flux. As a consequence, there are no stationary or quasi-stationary states. Indeed, expectations about the current and future state of affairs are always changing. With those changing expectations, market prices are also changing. The price system is functioning as a network for communicating relevant knowledge. It is also a discovery process that is in continuous motion, working toward creating a unity and coherence in the economic system. The speed of adjustment and the dissemination of knowledge in the price system depend on the scope and scale of the markets, however. ”

Forward markets connect and integrate people's expectations on future prices.

Enron specialized in transportation, distribution and transformation of these different commodities. Enron delivered price discovery and transmitted relevant information to the market. Enron's four core business areas were: wholesale services, energy services, broadband services, and transportation services. Enron hired Jeffery Skilling, who helped Enron introduce forward market to the deregulated natural gas markets. This allowed a lot more information to flow through the market which in turn led to price discovery and dissemination. This helped firms manage their risk more efficiently. Enron became the market maker! Enron brought liquidity to the market. Enron's GasBank idea was genius. Enron lost its comparative advantage when it tried to do its other 2 core businesses.

Enron's main business should have been asset lite-exploiting the synergies between a small physical market presence, a market-making function on derivative and a basis trading operation. Many of the

firms senior managers were unethical and this led to their downfall. "Without that spirit of innovation, the process of capitalism would grind to a screeching halt."