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Overview of the Book

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This book ranges widely over the different aspects of corporate practice and governance, law and ethics involved in the Enron case, and of the policy responses to the recent corporate scandals in the USA and internationally. Broadly, they can be classified under the following headings:

- **Transactions and institutional structure.** Major subjects here are Enron’s use of transactions such as derivatives and of institutions such as special purpose entities (SPE) to restrict the transparency of its operations. These practices have posed a major challenge to corporate governance.

- **Accounting and auditing.** This heading is closely related to the first, since the opaqueness of Enron’s operations was reflected in its financial reports and the accounting firm, Arthur Andersen, also served as adviser and consultant regarding the design and conformity with regulations of many of its transactions.

- **Corporate governance.** High-quality accounting and auditing are necessary for good corporate governance, but other parties – such as the firm’s Board of Directors its regulators, its banks and investors, credit rating agencies and investment analysts – all have essential roles here. These so-called ‘gatekeepers’ fell short in the performance of their duties in the Enron case. Failures under this heading have helped to shape recent reforms.

- **Corporate culture and ethics.** These dimensions of a firm overlap with corporate governance, since good corporate governance will not be achieved in the absence of an ethical corporate culture. The dividing line between corporate governance and corporate ethics is difficult to specify. Roughly, the first concerns major rules and norms related to a firm’s management and operations, and the relations between the main parties, (including those external to the firm, that assure, or are significantly affected by, its functioning); and the second concerns features of a firm’s organisation and functioning that are conducive to the observance of good corporate governance and ethical behaviour. Subjects under the
latter heading include not only the conduct of senior executives and other employees, but also business education and conceptualisation of the firm in management thought.

- **Ethical foundations (meta-ethics).** Not only corporate culture but also many other rules and norms governing business operations are related directly or indirectly to more fundamental values and moral principles. These are not a universal datum for different cultures and value systems, and the discussion in this book is inevitably highly selective.

The overview of the chapters that follow focuses on salient features of the contributions under these different headings, and on their mutual relations. It also points to questions that the contributions raise which merit, and will no doubt receive, more detailed consideration by others in the future.

### Enron: origins, character and failure

Several of the chapters describe aspects of Enron’s history and the collapse of Arthur Andersen. An overall account is to be found in Andrew Cornford’s Chapter 2. This describes the use by Enron of transactions and institutional structures to manipulate the firm’s financial reports and to avoid regulation. It documents the failings of Andersen, Enron’s auditors, of the Board of Directors, of the other ‘watchdogs’ or ‘gatekeepers’ mentioned above, and of the firm’s different regulators. The subject of Enron’s corporate culture is broached through a review of its hiring practices and its unusually rigorous but ultimately counter-productive system of incentives and sanctions for its employees. This serves as an introduction to more detailed discussions in other contributions of particular aspects of Enron’s operations and culture, as well as analogous features of other businesses in the contributions by the other authors.

### Transactions and institutional structure

It is now a commonplace of financial engineering that its instruments can be used to get round regulations and other operational constraints, such as banks’ credit limits to particular borrowers. Enron made extensive use of derivatives for these purposes, and perhaps more importantly to reduce the transparency of its financial reports. Derivatives are the linchpin of Frank Partnoy’s review of Enron in Chapter 3, and are central to his critique of the regulatory response in the USA. He brings out the extent to which Enron became a derivatives firm whose main source of profits was its trading of these instruments. SPEs played a subordinate role in Partnoy’s view, providing institutional structures that enabled Enron to exploit fully the potential of derivatives. As a trading firm, Enron absolutely required an investment-grade rating from the credit-rating agencies. As its ability to avoid regulations...