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Report of Corporate Failure

Prepared for

Mr. Peter Humphreys

University of Western Sydney

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Report

of

Corporate Failure

Corporate failure is a common phenomenon in economy and has significant consequences. However, to prevent corporate failure, the reasons for corporate failure need to be examined.

The purpose of the report is to identify what has caused corporate failure and how to prevent it in future. Consequently, the following matters must be covered:

- Reasons for corporate failure
- Consequences of corporate failure
- Preventions against corporate failure
- Benefits from corporate failure

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Introduction

Background

Rankin, Stanton, McGowan, Ferlauto and Tilling (2012) state that corporate failure regarded as when investors suffer huge financial detriment due to increased risk and the lack of disclosing financial information. Normally, insolvency and bankruptcy result in financial loss.

Different reasons cause companies to fail including internal and external factors. Rankin et al. (2012) state poor strategic decisions, power abuse, greed chief executive officers, ill-judged expansion, and ineffective firm management are main causes of failure.

This report focuses on the Enron Group to examine and analyse the internal reasons for Enron's failure.

Enron was an American company headquartered in Houston, Texas; its businesses concerned energy, natural gas and telecom services and it employed approximately 20,000 staff. Fortune named Enron as America's most innovative company for six consecutive years. Enron bankrupted in December 2001. For such a successful company, it collapsed in a short period. This report will discuss Enron's failure.

Discussion

How did Enron produce fraud financial report?

Enron founded offshore companies to increase paper profit and cover bad debts. By disclosing the internal trading benefit, Enron increased its paper profit. By transferring losses to offshore companies, Enron's accountants were able to produce false financial information. Kuruppu, Laswad and Oyelere (2012) declare that clear audit reporting is crucial to an entity, or result in enormous cost to both investors and the company. Accountants at Enron were supposed to take responsibility for its failure, because they failed to provide the true financial information. The fraud information misled the firm and investors and subsequently, caused the company to fail.

How power abuse occurred in Enron?

Stasio (2010) states both Enron's chief executive officers and chief finance officers sought personal benefits by misusing their power, and inside trading occurred under the circumstance. Inside stock exchange means insiders use mastered inside stock information or provided information to others to gain extortionate profit. In Enron's case, it occurred through managers' secret operation of stock prices. And Enron's auditors confirmed this. However, the chief executive officers stopped the further investigation because they participated in the trading of stock and benefited themselves. Conversely, in the Enron Corporation, other shareholders and investors suffered financially. Obviously, Enron's leaders misused their power to seek their own interests rather than the firm's. This caused Enron to collapse speedily.

What was the effect of poor corporate governance?

Mallin (2013) states that corporate governance is a set of principles or polices which provide guidelines to direct and control a company. Well-executed corporate governance can assist a company to make good decisions, ensure it performs with ethical standards and increases the accountability of the company.

However, in Enron's case, it was believed the response of the board of directors was to monitor the firm management and protect the interests of shareholders. But, the board of Enron disregarded the rule; they did not avoid conflict interests between company and personal roles. By using tricky accounting techniques, they sought personal profit, created favourable financial results, and hid the losses. In addition, there was significant influence on independent board and auditors because of the complex relationship within the board members, which affected each other negatively and led the company in the wrong direction. The issues clearly exposed the truth of Enron's failure in poor corporate governance.

What were the consequences due to Enron's failure?

Enron's failure had significant consequences. It had a detrimental effect to global economy (Rundgren 2012), many of Enron's trading partners such as Morgan suffered huge losses because of the disastrous fall of the whole stock market. Also, Enron's failure caused Arthur Anderson and WorldCom to collapse. Due to the significant effect on the American economy, subsequently, there was a vicious influence to the global economy. Anderson's firm collapsed and lost billions of dollars. Many employees at Andersen's company who were completely uninvolved with the Enron's audit also were laid off. The fall of Enron was the trigger of the reliability crisis in the auditing industry. The public lost confidence to invest and were afraid to buy stocks. Enron's employees lost their jobs, pension and superannuation funds.

It is apparent that Enron's failure caused terrible consequences to global economy and society, even was disastrous for Enron itself (Stasio 2010).

How to prevent the failure in future?

There are three main preventions of corporate failure. One is efficient financial management. Skim (2008) indicates financial management includes cash management which is vital in business. Efficient cash management ensures expenditures are less than revenue. If the business has more expense, liability will be greater than assets. To take action, high debt avoidance then comes in. Any form of liability, including loans and credit cards, can be a double-edged sword for a business. Even though most companies start off with a loan to take their business to the next level, if a business spends more on repaying the loan than improving the operation of the business, it may spiral down to failure if not avoided.

Another action to prevent corporate failure is efficient corporate governance. Monks and Minow (2011) declare necessary changes in management style will improve firms' business performance more efficiently. If current management does not work, then bringing someone new with expertise to change the current managing style. Efficient management allows the entity to know where the business is and where it wants to go. In addition, ethical behaviour is an important part in conducting firms. However, Prebble (2012) claims that Enron's chief executive officers were greedy, sought personal interests and made poor decisions. With good ethical behaviour, every level of management will not have a conflict in interest between business entity and personal (Monks & Minow 2011). It means that they must act in the best interest for the company rather for personal benefit. Consequently, developing a strong business plan with good ethical behaviours will help prevent failure efficiently.

The third aspect refers to effective response to customers' feedback. Effective responses to customers' needs and wants will help an entity to gain more profit. Conversely, businesses that do not understand what the customers' want are subject to failure (Clough & Hudson 2005) because customers will look for another company who can cater to their needs. Therefore, listening to negative feedback from customers is important. It might not be good to the ears, but business can benefit from customers' own ideas. Hence, take efficient responsible to negative feedback will help the businesses to be aware of what the bad points are from customers' perspective and address them. This will help an entity improves on these potential pitfalls and avoid failure.

Are there any benefits from corporate failure?

Darwin stated in evolutionism, natural selection is the survival of fittest. It also occurs in the economic market. A company who lack competitive spirit deserves to fail. With part of such corporate bankruptcy, the allocation of capital will be more efficient and effective. Subsequently, there will be overall socio-economic benefits.

From the perspective of economic development, the collapse of a failed company is an elimination of companies with poor business performances. Such entities are like the sick cells of a human body; they must be dealt with to maintain health, and metabolism will help to achieve the purpose. It is the same in the economic market. The elimination of a failed entity is a way of the market to cure itself, and then develop to be better and stronger.

Conclusion

The report has analysed three main internal reasons of Enron's failure, they are fraud of financial information, power abuse and poor corporate governance. In regards to fraud, the report discussed the procedure Enron used to produce the information, followed with how it abused its position of powers. In relation to corporate governance, the poor management of Enron was exposed. After examining the reasons of Enron's failure, the terrible consequences were presented. Also, the report provided some reasonable approaches to prevent similar failures in the future and mentioned the benefits that can be gain from corporate failure. After weighing the evidence, it is possible to conclude that most corporate failure is due to internal reasons, and can be prevented with efficient corporate governance and proper disclosure of financial information.

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