Enron: The Last dot-com
Twenty years ago, in his song I am Changing my Name to Chrysler, folk singer Tom Paxton outlined the rules of Washington power politics. Political connections (“I will tell some power broker what they did for Iacocca will be perfectly acceptable to me”) would lead to government help (“If you’re a corporate titan and your failure is gigantic, down to Congress there’s a safety net for you”). However the recent events of Enron have changed the rules. A company that might once have been viewed as too large to fail, is suddenly too connected to save.

Enron’s collapse will be studied for years to come. Analysts see similarities to Long Term Capital (a hedge fund which threatened to cause the collapse of the world’s financial system) because of the spectacular failure which resulted from negligence to remember risk in the face of extreme results. Others cite Drexel, Burnham Lambert, where a small group of people with questionable ethics changed the rules of business.

Many believe Enron to be the inevitable conclusion to the dot-com bubble. The self-serving financial frenzy came first, when Wall Street analysts helped elevate the stock while simultaneously soliciting investment banking engagements. Many “experts” still recommended the stock as it began to plummet. Failure to understand the limits to Enron’s business model probably contributed to the problem. Outside of energy trading, Enron was vaporware — the products didn’t work. Like so many Internet startups, it appears the Enron model could only make a small fortune when it started with a large one.

Transportation was not immune to the dot-com frenzy, which has left its imprint on our industry. Hundreds of public exchanges and application service providers (ASPs) with flawed business models have come and gone in the past three years. But these early initiatives have given way to private exchanges and portals that promise to bring e-commerce success to transportation.

During the dot-com frenzy, the logistics industry also caught IPO fever. Wall Street bestowed 15 minutes of fame on these non-asset-based companies, many of which have already failed — and several planned IPOs never even occurred. Transportation industry consolidations (“roll-ups”) are also struggling for survival.

Theory and practice frequently live miles apart. Paul Krugman of the New York Times pointed out that “Enron’s business plan made a perfect PowerPoint presentation.” But instead of hiring consultants, Enron put the consultants in charge. The result was a company “so trendy that investors were dazzled.” Intellectual prowess became arrogance as executives felt they could run industries they didn’t understand. The few analysts and reporters who asked questions of Enron’s management were ridiculed — or worse.

Similar misfires have burdened the transportation industry, which has seen a number of carrier merger and acquisition failures in the last decade. Much of this business was undertaken at the behest of investment bankers, and guided by world-renowned consultants. Some transactions took years to recover from — and some were just plain failures. Often, the unsuccessful acquirer became the acquired.

We’ve learned in recent months that Enron’s financial results were fiction. Mark-to-market accounting made every “hockey stick” revenue projection reality. Like the dot-coms, Enron resorted to the business development tactic of announcing deals to suggest they were producing real revenue (i.e., Enron claimed $110.9 million in profit from a Blockbuster partnership that had no paying customers). All of this manipulation supported a high stock price — which was used as currency for business deals.

Transportation companies too, wish to accelerate revenue recognition and defer expense. Some non-asset companies have played the same game as Enron. (On intermediated transactions they may show the total transaction amount as revenue, rather than just their margin, in order to inflate their reported revenues and show growth.)

Overwhelming disdain has been expressed over Enron executives who sold stock while most employees could not. Elsewhere, dot-com founders tried to get employees to invest in early rounds — a direct violation of SEC rules limiting investment to accredited investors.

Senior management of transportation companies have generally enjoyed or endured the same gains and losses as the rest of the company — only more so. In fact, some companies strongly discourage executives from selling stock and some informally insist on equity holdings based on salary.

Enron resembled failed dot-coms by having a board of directors who provided minimal oversight. Many Internet dot-coms might have succeeded had their board been paying attention to early signs of failure. Many dot-com boards probably failed to jettison company founders when there was still time (and cash) to save the enterprise. Enhanced vigilance by corporate boards will undoubtedly characterize the post-Enron world. (Increased D&O insurance expense will accelerate this trend.) Some analysts believe that a smattering of transportation companies are also overdue for increased board activism and the breakup of comfortable board relationships which don’t benefit shareholders. Senior management may no longer be able to protect their jobs with contract extensions, which traditionally are intended to reward success. Some public companies, which today run like private, family businesses, may have to change to survive.

Transportation insiders are reminded of the Penn Central bankruptcy. It was the largest bankruptcy ever, at its time, and it occurred very quickly. Poor management and financial reporting were key components of the bankruptcy. Despite personal relationships which might have protected the company, the federal government allowed the company to collapse, leaving customers and employees in dire straits. Railroad bankruptcies followed. The aftermath saw significant legislation which forever changed the railroad industry. The 3R and 4R Acts led to the creation of Conrail — and the Staggers Act enabled deregulation. Ultimately, the industry became stronger.

Of all the problems surrounding Enron’s failure, one item has escaped discussion. Enron was trying to enter freight markets as a market maker for price and capacity. Some of this was to control market maker for price and capacity. Some of this was to control transportation for commodities traded by Enron (i.e., steel and forest products). But some was pure trading. Most Class One railroads were uncomfortable with Enron’s initiatives.

Most railroads recognize that future financial success lies with extracting greater value from their franchises. Simply increasing volume is no longer enough. The challenge is extracting untaept value which exists in better capacity management. All asset-based carriers face this challenge, but most require some sort of reservation — except for railroads (These are some exceptions). Ultimately, activities arising from Enron’s freight market initiative may prove to have the most lasting impact on the transportation industry.

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