By Philip Burgert

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Online Trading

Enron's Collapse Gives Lessons For E-Markets

Last fall's rapid collapse of EnronOnline e-marketplace parent Enron Corp. provides a number of lessons worth considering by executives and managers involved in supply chain planning who are now online or considering going online.

Enron suspended online trading of energy and other commodities just before filing for bankruptcy in December and after its share prices had tumbled to less than $1 from a peak of $90 a year earlier. Because of Enron's wide political connections and its handling of employee pension investments, the bankruptcy has become a much more widely covered scandal since that time.

Before its collapse, EnronOnline's trading liquidity had been seen by some as a success story among e-marketplaces. Gartner Inc.'s GartnerG2 unit had only a month earlier listed Enron as having the largest e-marketplace in any business, with 43% of the e-marketplace industry's sales transaction volume in 2000. Enron was also considered the largest U.S. natural gas and electricity trader, accounting for 20% of daily trade in those markets.

An irony of Enron's collapse is that it had grown by promising its trading partners a way to limit their risk through forward trading and other techniques. But in the end Enron itself was the victim of its own risk taking.

"What we decided is that we were going to use e-commerce and the Internet to kind of energize or turbocharge our existing business model rather than get involved in e-commerce and the Internet as a business itself," Greg Piper, CEO of Enron Net Works, the operator of Enron Online, told me before the collapse last fall.

The idea of EnronOnline's real-time Web-based trading of commodities started in Europe in the late 1990s with Piper's predecessor, Louise Kitchen. Trading started in November 1999 and later spread to include 30 commodity markets, including metals, crude oil, forest products and even weather futures.

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"We needed to deal with issues that are very important to us like credit risk and the counterparties that we deal with and legal issues around the contracts," Piper told me. "In our markets we have a lot of specific legal language around how commodities are dealt with, and when we started to put together those requirements for the domain that we're in, it became obvious to us that on the application side we needed to write those business rules and how we would deal with the clients ourselves."

A major focus of the investigation of the collapse has been on the accounting practices behind the company, but the scandal also should stimulate efforts to provide even more visibility for participants into the internal workings of e-marketplaces. EnronOnline, for example, used "notional value," or by definition "not actual value," to list its revenues, which is now leading to questions about whether the company was ever the seventh largest U.S. company or the 287th largest.

AMR Research Inc., Boston, and analyst Jill Feblowitz say almost half of all energy trading will still be conducted online by 2005, despite the collapse of Enron. "The Enron case has brought attention to risk management and especially counterparty risk," Feblowitz says. "Energy companies should take a serious look at their trading and risk management systems."

Jim Walker, an analyst with Forrester Research Inc., Cambridge, Mass., says a single, multi-party exchange—most likely Intercontinental Exchange—is likely to emerge for trading high-volume energy derivatives, while online commoditization of non-energy products like steel and shipping will be delayed at least two years by the collapse.

Yes, there needs to be balance in any disclosure of corporate strategies or attempt to regulate online markets. And yes, it is notable that there has been substantial stability in the markets for commodities traded by Enron, showing that free markets and competition are effective.

But online trading should join the accounting industry, Wall Street, pension planning and others in using the demise of Enron as a stimulus for promoting more openness, visibility and full disclosure to its constituents in the future. ECW