SAVING THE COMPANIES AFFECTED BY THE CURRENT ECONOMIC CRISES – AT THE HAND OF STAKEHOLDERS AND ACCOUNTING PROFESSIONALS

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Abstract

The current economic environment is characterized by uncertainties related to price volatility, difficulties in the valuation of financial instruments, as well as of assets and liabilities in general. More and more companies face liquidity issues that could even threaten their existence. Under these circumstances, saving such companies becomes a major concern for the ones directly interested, “survival” being the term most used in the current state of the world’s economy.

In the context of this economic turmoil at international level, the main stakeholders and the accountants professionals find themselves in the position of revising their procedures, objectives, strategies, but also their behaviour, their attitude in general, in order to limit or even eliminate the negative consequences of the financial crisis. From our perspective, the communication among company, stakeholders, and auditors represents the fundament of a successful business strategy. However, communication difficulties could be encountered, especially under conditions of uncertainty and crisis.

The present article intends to identify the opportunities and threats generated by the economic crisis and to analyze the information flows among company, stakeholders and accountants professionals under circumstances in which the going concern assumption is threatened. Our paper emphasizes the importance of communication among company, stakeholders, and auditors in saving the firms affected by the economic crisis.

Keywords: *economic turmoil, stakeholders, accounting professionals, communication, transparency*

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Introduction

The break-out of the world economic crisis, which has initially started with a financial crisis, caused by unprecedented increases in credits (stimulated by a long period of moderate financial and economic conditions) is opening the road to changes affecting companies, stakeholders and the relationships between them, as well as to changes at the level of the whole society. These changes are rather answers, reactions, effects of the adaptation to the new unfavourable economic background. Usually, change involves multiple, ample, long processes, that are necessary for survival within new economic coordinates and which use specific tools, whereas one of the most important is communication.

Our paper presents the current situation and the causes of the economic crisis, aspects related to corporate governance and the role of the stakeholders in the enterprise's life and the

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economic environment, but also the reaction of the stakeholders to the current economic changes. Last but not least, we presented the role and importance of communication in times of financial crisis, as main survival factor and even exit from the crisis.

1. Current Situation and Causes of the Economic Crisis

The financial crisis that broke out in the summer of 2007 is striking in its magnitude, its speed of spreading internationally and in its persistence, since it is far from being over. At present, the financial world is characterized by risk adversity, reduced liquidity, price volatility, uncertainty regarding the future of financial institutions, doubts related to the quality of the structured credit products and uncertainty about the macroeconomic prospective in general. A number of factors contributed to the break out of the current economic crisis, among which: the expansionary macroeconomic policies of the United States of America to restore the economic growth affected during the previous crisis from the first half of the century, excessive distribution of credit, the use of complex financial instruments without having realistic image on the associated risks etc. Some authors also mention lack of economic cooperation between major countries (*Report on the Financial Crisis*, 2008, pp.3) [1].

This turmoil in the most advanced financial markets was the consequence of an exceptional growth of credit, stimulated by a long period characterized by benign financial and economic conditions. During that period, there were extremely low real interest rates, whereas no liquidity problems existed, which raised the level of risk that creditors, investors and intermediaries were willing to take on. In conjunction with this, financial innovations expanded the system's capacity to generate credit assets and leverage but outpaced its capacity to manage the associated risks (*Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience,* 2008,pp.5) [2]. A sophisticated and apparently stable system was established, which consisted in originating extremely complex financial instruments that allowed banks to offload risks (especially in the United States of America). These financial instruments were then distributed and bought – mostly in Europe, without paying proper attention to the underlying assets and the real economic fundament of these instruments (*Report on the Financial Crisis,* 2008, pp..3).

The expansion of complex financial instruments was also encouraged by favourable credit ratings that implied assets were high-quality and low-risk. Financial guarantors contributed further to the perception that investment opportunities were unlimited and of high quality. As a consequence, the perceived liquidity of credit instruments increased. Additionally, several factors led to lowering the standards used in analyzing the eligibility of clients who wanted to benefit from the products of the financial institutions. Some of these factors were: relatively stable macroeconomic conditions, increased competitiveness among financial institutions, low interest rates, rising house prices, weak government oversight. Thus, the products of the financial institutions (in particular credits) were given much easier, and this lead in some cases to fraudulent practices (*Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience,* 2008, pp.5).

Despite that, neither investors nor banks, and not even rating agencies correctly assessed the risks associated with this kind of financial instruments that deterioration in general economic conditions would pose (*Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience,* 2008, pp.7). Standard risk management instruments used by financial institutions were not appropriate in estimating the impact of potential losses connected to structured credit products. The absence of a history of returns, the complexity of many of these products created uncertainty regarding estimated risks (*Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience,* 2008, pp.7). Market participants underestimated default risks, market risks and liquidity risks. In some banks, the control over off-balance sheet risks, as well as the communication across business lines and functions was weak. As a result, when turmoil began, most companies, investors, other stakeholders, as well as the society as a whole were not able to correctly and rapidly assess risk exposure. The stakeholders‟ role is very important in conjunction with risks, because they have enough instruments for saving the companies and the economic environment from the imminent "disasters" that could be the consequences of the world's economic crisis.

2. Corporate governance and the role of stakeholders in the company's life and in the economic environment

In theory it is considered that the concept of enterprise refers to a single entity which operates harmoniously and whose main goal is to maximize value and shareholder wealth. Due to the appearance of new elements and complex needs, other views on the enterprise have been developed. Thus, the definition of the enterprise could be based on the concept of social interest, with the purpose of generating wealth as a result of the participant's collaboration in the company's life (shareholders, managers, creditors, employees, customers, suppliers, public power). Thus, the objectives of a company are of social nature, but also relate to maximizing profits (Feleagă N., 2006, pp.69) [3]. The definition developed under the first theory leads to financial information directed towards investors, while the second definition is oriented to satisfy the financial needs of all users (Feleagă N., 2006, pp.69).

One of the key factors that influence the efficient use of resources, the increase of the confidence shareholders have in the enterprise managers, the success in achieving the company's objectives and the economic efficiency is the corporate governance system by which a company is controlled. This system promotes fairness and transparency at company level, and consists in a set of rules of conduct that aims the welfare of the society as a whole, but mostly the welfare of the shareholders and other stakeholders: managers, creditors, employees, customers, suppliers, public power, etc. (*World Bank*, 1998, pp.7) [4].

Shareholders, one of the key elements of the company, bring the funds necessary for the activity, and are in turn interested that these funds are used and managed well and fairly by the managers appointed for this purpose. The relationship between owners and managers is controversial, because the two categories of participants may have different interests, often contradictory. For example, the shareholders have, in general, a greater preference for risk, because their securities portfolio is diversified, while managers are more risk-adverse, because all financial interests and of other nature focus on a single enterprise (Feleagă N., 2005, pp.171) [5].

Agency theory, by which the company is seen as "a knot of contracts" (Feleagă N., 2005, pp.51), is the one that makes it possible to solve "the conflict of interests between the shareholders and the managers of an enterprise" (Feleagă N., 2005, pp.171). This theory establishes a set of relationships, with mutual benefits, on the one hand, between shareholders and managers, but also between other parties interested in the smooth running of the company (employees, creditors, etc.). However, the shareholders-managers relationship is the one that generates the most complex conflicts of interest and settling them is closely related to the organization of an effective system of governance which "encourages that the interests of the managers are aligned to the ones of the shareholders" (Feleagă N., 2005, pp.170).

Stimulating managers so that they fulfil their responsibilities with fairness refers in principle to financial benefits (salary, implementation of a stock-option plan that creates benefits such as dividends and increases of value generated by the sale of the company's shares), but also to benefits in kind (company car, company house, etc.).

Auditors play an important role in the conflicts of interest between shareholders and managers. They make a fair, impartial, independent evaluation of the financial statements of the enterprise, having the role of showing shareholders the real situation. Through external audit, shareholders benefit from an important tool to assess the efforts of managers in achieving the company's goals, and in maximizing the wealth of owners.

Creditors are third parties who provide loans to companies, and look out for interest and principal. Thus, creditors are directly interested in that company obtains profit as this will be the source of payment of the related loan interests. As for the shareholders, the loans can be a viable solution for obtaining new funds, but the associated risk may be high, because the effective administration of the equity thus obtained depends on the attitude, skills, and especially on the interest of the manager.

Employees have multiple interests within a company. They represent one of the most important resources available to a company. The main interests of the employees concern the remuneration level, the benefits in kind (meal and gift tickets, phone, life insurance, trips, company car, etc.), the security and the work conditions etc. For this purpose, the employees follow the evolution of profitability and the business continuity of the company.

Customers and suppliers are the trading partners of the company. Customers are interested in the ability of the company to continue its activity and in its prices, because they are directly interested whether their supplier can provide to them the goods/services they need for the smooth running of the activity. Suppliers have in view whether the customer-company has sufficient resources to pay its financial debts (Feleagă N., 2005, pp.57).

The corporate governance system may differ depending on the importance given to the categories of participants, but the relationship between shareholders and managers occupy the central position, as their relationship has the most divergent elements.

3. The Impact of the Current Financial Crisis on the Main Stakeholders and Accounting Professionals

3.1. Managers, Investors and Auditors

Managers are the ones who, by using a series of laws, principles, methods etc., as well as their own competences and abilities, run the company towards achieving its established purposes. They are charged by investors with using the company's resources (from equipment to employees" knowledge and competences) in order to achieve business success. For investors, who took financial risks, success means, in most of the cases, financial performance, namely profit. However, the objective of maximizing profit set by investors is not always the objective of the managers, who are often tempted to follow their own interest, at the expense of the investors. Under financial crisis, managers and investors focus more on their own interests, sometimes opposite to one another. However, it may happen that the objectives of the managers and those of the investors are the same, since both are interested in survival and exist from the crisis.

Since investors do not always have the benefit of direct contact to the responsible managers, the ones that act instead of them and protect their interests are the financial auditors. Financial auditors are independent experts that express their opinion on the financial statements of the companies, their interest being whether these statements provide a true and fair view. Under financial crisis, the role of the external auditors has an increased importance, and banks and supervisors rely more and more on the expertise and judgment of external auditors. An audit conducted in accordance with international audit and ethics standards, under independence, integrity and professional competence, can provide a number of benefits to institutions, companies, financial systems and supervisors (*External audit quality and banking supervision*, 2008, pp.2) [6].

Audits increase the confidence of market participants by increasing the credibility of the financial statements, especially under economic turmoil. Although it is not one of their main objectives, auditors can help identify weaknesses in internal control relating to financial reporting and thus can contribute to safe and sound bank systems. Most of the world's credit institutions undergo audits, and supervisors rely more and more on high quality bank audits that complement the supervisory processes. In the context of globalization, most audit companies expanded at international level, and consequently, their structures are complex and corporate governance within audit companies is characterized by difficulties in insuring transparency (*External audit quality and banking supervision,* 2008, pp.8). Therefore, the audit profession faces new challenges within the current financial crisis.

One of these challenges refers to testing the going concern assumption, which is fundamental in preparing financial statements. Most of the financial statements are prepared based on the assumption that the entity is continuing in business for the foreseeable future with neither the intention nor the necessity of bankruptcy, liquidation or reducing activity (ISA 570). The auditor is in charge with verifying the appropriateness of this statement made by management, as part of its responsibilities to prepare the financial statements of the company. Under economic crisis, it is expected that more and more companies put question whether they will indeed continue as going concern in the foreseeable future (which usually means over a period of more than 12 months) (*Audit Considerations in Respect of Going Concern in the Current Economic Environment,* 2009, pp.5) [7] As a consequence, the auditor will need to pay particular attention in conducting the specific tests related to this aspect.

Before the financial crisis, auditors had a relatively passive role, because they analyzed the evidence on which the management made the going concern assumption and investigated the soundness of this evidence. Nowadays, auditors are challenged to take a more active role, to search in an alert and independent manner the factors that could dismiss the management's assumption and that could lead to issuing an adverse opinion. Another challenge for these accounting professionals is auditing financial statements based on fair value measurement. Both measuring fair value and verifying this measurement is difficult due to its complexity and involves subjectivity and uncertainty, especially under crisis. Therefore, the auditor will need to develop his/her competences in order to adapt to the new situation.

3.2. Creditors

The company's need for funding can be satisfied through loans from bank lenders, from companies within the group etc. To determine the ability of reimbursement of the loans, the bank lenders take into account the fair value of the items, not the historical value. The prudence that they manifest may conduct to an undervaluation of the assets and an overvaluation of the debts in order to ensure a safety margin (Feleagă N., 2005, p. 56) .

Creditors assess the liquidity indicators of the companies funded, but also "the personal, technical, moral value of the managers, the general situation of the activity branch the enterprise is part of, the general situation of the company (the nature of products, the quality, the price, the customers, the suppliers) and the financial situation of the enterprise "(Feleagă N., 2005, p.56). Bank creditors document their lending decision according to the company's size and closely analyze the evolution of loans reimbursement. However, due to non-compliance with the general principles related to loans, the imprudence of bank creditors led to the break-out of the global financial crisis in 2007.

As a normal reaction, in times of financial crisis, the attention of bank creditors grows significantly. While in normal conditions, prudence is the basic principle, during financial crisis, lenders focus on excessive prudence, on business continuity of companies, on their ability to maintain profits, on the degree of liquidity, but also on the human factor, especially on managers, on their behaviour, the measures taken to survive, and also to exit the crisis.

The refusal of bank creditors to fund a company can lead to a liquidity crisis. The permanent communication between creditors and managers, the fair description of the company's situation, the flexibility, the transparency and the fairness are key factors for establishing a viable relationship between creditors and companies. In crisis conditions, survival is the main objective of the companies and funds are primary. However, if loans are not efficiently used, it can lead to bankruptcy.

During difficult economic conditions, the loans from companies within the group represent a reliable alternative. The conditions for obtaining such loans may be more permissive, the interests – lower, or the reimbursement periods – longer. However, the funding alternative is available only to larger companies, who are part of a group of enterprises.

3.3. Other stakeholders – employees, customers, suppliers

3.3.1. Employees

Survival remains the biggest challenge in times of financial crisis. However, survival is understood in different ways by the managers and the employees of a company. If managers believe that survival means reducing the number of staff, for sure, the employees will think exactly the opposite, because the disposal would affect their welfare, as the unemployment period may be longer than normal. On the other hand, accepting a number of employees too large in comparison with the necessities of survival or continuation of activity can lead to inefficiency and even bankruptcy.

In crisis conditions, the employees are interested not to lose their job, and to maintain the same financial and other benefits. Therefore, the permanent communication with their managers, the active participation in the business of the company, or on the contrary, the more or less violent confrontations between managers and employees are some of the possible effects related to the reaction of employees during these difficult conditions.

3.3.2. Customers and suppliers

Trading partners demonstrate more prudence when there are going concern issues. Customers are mainly interested in the company's going concern assumption, but they also have in mind the possibility of negotiating prices easier. On the other hand, the suppliers are interested and analyze more strictly the profitability of the companies and their ability to pay the financial liabilities. However, the monitoring of debits and deadlines is the main objective of suppliers in times of financial crisis. The improvement of the relationships between the trading partners and the companies can be achieved through communication and informational transparency.

The financial crisis leads to significant changes in the behaviour of stakeholders. The reactions differ depending on the role of the participants in the company's life. To avoid bankruptcy and conflicts of interest, managers should adopt a flexible attitude, adapt to the demands of the stakeholders involved and not at last, insure permanent communication between company and interested parties.

4. Importance of communication under economic crisis

Most economic crisis lead to rumours, to distorted perceptions regarding the economic environment, to stress, to lack of control, to panic, to disorientation, to uncertainty, to lack of security and even to major lack of balance in the whole society. The first affected by the above mentioned facts are companies, their owners and managers, but also other stakeholders and parties directly involved in the life of a company. They may have reactions such as denial, avoidance of responsibility, disclaimer of culpability, justification. Finally, the reactions are transformed into positive ones: acceptance, remediation, corrective actions, optimism and confidence. One of the factors that make the transition from a negative attitude on the crisis to a survival-oriented behaviour, if not to optimism, is the communication between the company and stakeholders and between the company and the economic environment as a whole (fig. no. 1).

Individuals react differently to a given situation. Their personality, temperament, and the environment in which they have developed and worked, the psychological, social, economic, political factors and the factors of other nature have led to different, complex, sometimes opposed reactions. Social context involves individual's interaction, which can be achieved mainly through communication. The role of communication is important because it can lead to sustainable and productive relationships between individuals or to the opposite reactions of rejection, conflict, and indifference. Human relationships influence the creation, the existence and the development of the enterprises, and of the economic environment.

Companies cannot exist without individuals, whereas a powerful connection is created: individuals depend on the existence and the proper functioning of companies, while companies cannot exist in the absence of individuals.

The strong link that has been created between the different categories of individuals, due to the interactions between them, had as starting point communication. In times of financial crisis, communication takes magnitude, since individuals need accurate information on the facts (in order to eliminate rumours and distorted perceptions of the economic environment). On the other hand, using communication and tools offered by psychology, individuals can recover their balance (by eliminating stress, lack of control, panic and disorientation). Last but not least, the uncertainty, and the lack of security and balance can be controlled and removed only when panic and disorientation in the society are reduced. Thus, individuals can make correct and rational decisions related to the crisis situation, can identify the causes, clear them off and restore the social and economic balance.

For these reasons, correcting the negative effects triggered by the economic crisis is the first step to getting out of the crisis. However, the responsibility for these actions is to be taken by individuals (stakeholders) whose main tool is communication.

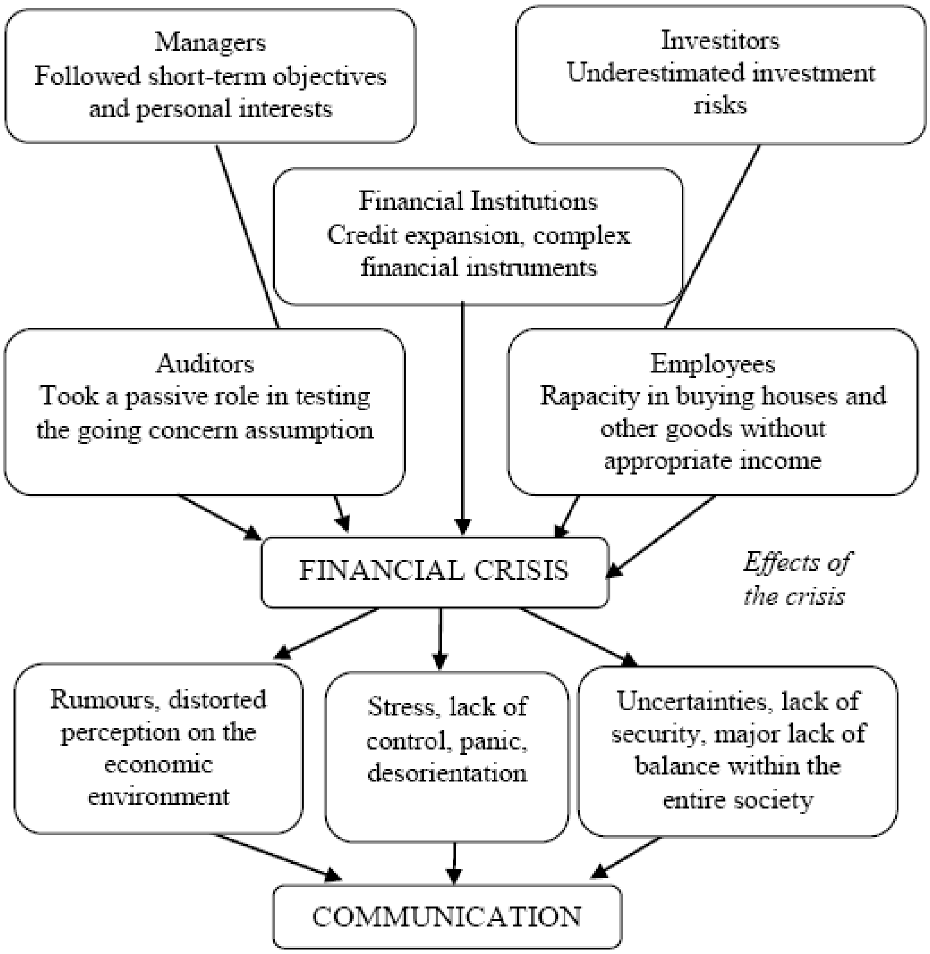

Fig. 1: The phenomenon of financial crisis

Conclusions

The effects of the financial crisis that broke out in the summer of 2007 at international level are also felt today. The uncertainty, the increasing number of cases of bankruptcy, the risk adversity of investors, the reduced liquidity, the stricter credit conditions, the price volatility are only some of the features of the crisis phenomenon.

All participants in the economic life are affected, directly or indirectly, more or less, by the current crisis. As a consequence, changes are necessary, both in attitude, but also in the undertaken actions, whereas communication is essential as instrument of survival and exit from the crisis.

Managers, who are responsible for their company's well-being, will need to develop survival strategies and powerful instruments of risk management. Moreover, prudence and conservatism will characterize the attitudes of investors, who before crisis started, were willing to take risks. Creditor, who proved to be quite tolerant in the period of credit expansion, will become stricter in analyzing the eligibility of their potential clients. The importance of auditors will increase, because creditors, investors and the public in general rely on their opinion as independent expert. Employees will become directly interested in the success or failure of the company where they work, due to their dependency relationship with the employer. The driver for all these changes in attitude will be communication.

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