NEW CHALLENGES FACED BY EUROPEAN COMPANIES AND THEIR STAKEHOLDERS

Mocanu Mihaela
University: Academy of Economic Studies, Bucharest, Romania
Faculty of Accounting and Management Information Systems

Bobe Claudia-Maria
University: Academy of Economic Studies, Bucharest, Romania
Faculty of Accounting and Management Information Systems

Sasu Dinu-Vlad
Universitatea din Oradea, Oradea, Romania
Facultatea de Ştiinţe Economice, Catedra de Management şi Marketing

The European Union is currently affected by the financial crisis that spread internationally. The member states face difficulties such as price volatility, uncertainties, liquidity issues, cases of bankruptcy, increased unemployment rate, and decreasing GDP. The present paper analyses the challenges faced under these new circumstances by the European companies and their stakeholders. By taking into consideration the threats and weaknesses faced by firms and other interested parties, we emphasize the importance that transparency and communication among companies and their stakeholder have in overcoming financial difficulties.

Keywords: economic turmoil, stakeholders, communication, challenges, corporate governance

JEL Classification: G30

Introduction

The present paper covers aspects related to the current situation of the European Union and the causes of the economic crisis that affected the member states. The authors analyzed not only the effects, but also the chain of events that lead to the current crisis. The break-out of the world economic crisis, initially started with a financial crisis, caused by unprecedented increases in credits that were stimulated by a long period of moderate financial and economic conditions. As a consequence, this crisis is opening the road to changes affecting European companies, stakeholders and the relationships between them, as well as to changes at the level of the whole society. What are these changes and what possible directions of actions should be adopted are the main questions this paper tries to answer. As a result of their analysis, the authors emphasize the role and importance of communication in times of financial crisis, as main survival factor and even exit from the crisis.

1. Current Economic Situation of the European Union and Causes of the Financial Crisis

The fifth anniversary of the largest recent enlargement of the European Union is marked by financial difficulties faced by the member states. 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 now characterize the EU economic environment.

The current turmoil was preceded by a period of benign financial and economic conditions, with low real interest rates and no liquidity problems. The consequence was an exceptional growth of credit, since investors and intermediaries were willing to take on higher risks. In conjunction with this, 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[428]. This excessive distribution of credit, the use of complex financial instruments, the underestimation of risks and even the lack of economic cooperation between major countries within the European Union and globally have led to the current financial crisis.

However, the report of the Economic and Financial Affairs Council (ECOFIN) called "Five years of an enlarged EU: Economic achievements and challenges" states in an optimistic tone that "the recent EU enlargement was not only a historic step in unifying a long-divided Europe but also a success from an economic point of view resulting in a win-win situation for the whole EU"[429]. The objective of the European Union structures currently refers to using the created synergies in order to diminish the negative effects of the financial crisis in the member states. The European Council in 2008 agreed on a European Economic Recovery Plan, based on a proposal of the Commission. Moreover, the Council of the European Union has recently drafted country-specific recommendations that have in view the particular economic situation in each member state[430].

2. Corporate Governance. The Impact of the Current Financial Crisis on the Main Stakeholders and Accounting Professionals

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[431]. 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[432].

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.[433]

Across the European Union, there are several corporate governance models which have distinct characteristics: the Anglo-Saxon corporate governance system (specific for Great Britain) and the German system (specific for Germany and for Continental Europe countries). The Anglo-Saxon model has a "shareholder orientation, with the expectation that other stakeholders will indirectly benefit from the active pursuit of shareholder interests". The German system "is more orientated towards a stakeholder approach, in the sense that employees are also included in the internal governance process"[434]. Although, the corporate governance systems may differ, the managers, investors and other

[428] Report on the Financial Crisis 2008, drafted by René Ricol, p. 3.
[429] Council Conclusions on Five Years after European Union Enlargement 2009, p.1.
[430] Council Recommendation on the 2009 up-date of the Broad Guidelines for the Economic Policies of the Member States and the Community and on the Implementation of Member States' Employment Policies 2009, p.3.
[431] Feleagă N. 2006, Criza financiară la cumpăna dintre secolele XX şi XXI şi guvernanţa întreprinderii, Economie teoretică şi aplicată nr. 9, p. 69.
[5] Feleagă N. 2006, Criza financiară la cumpăna dintre secolele XX şi XXI şi guvernanţa întreprinderii, Economie teoretică şi aplicată nr. 9, p. 69.
[433] The Business Environment and Corporate Governance 1998, World Bank 1998.
[434] Rossouw G.J. 2009, The Ethics of Corporate Governance – Global Convergence or Divergence?, p. 44.

stakeholders have different behaviors in relation to changes of the economic environment that recently stroked over Europe.

2.1. Managers, Investors and Auditors

There are several challenges that European managers, investors and auditors face under the current financial crisis, which highlighted certain weaknesses in the related management, investment and auditing processes. It is a known fact that managers and investors have contrasting interests and different views on the success of a company. Whereas for investors, who took financial risks, success means, in most of the cases, financial performance, namely profit, managers are often tempted to follow their own interest, at the expense of the investors., However, under the current economic situation, it may happen that the objectives of the managers and those of the investors are the same, since both are interested in survival and exit from the crisis. Therefore, a challenge for investors and managers would be to cooperate better towards improving their risk management systems and bringing their company financial success.

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. Their interest is to obtain a reasonable insurance that the financial 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 as independent and upright experts[435]. Auditors in the European Union also face new challenges, since political, social and economic pressures on them are now higher then ever. Currently, two widely used sets of auditing standards exist side by side, i.e. International Standards on Auditing (ISAs) and the US standards adopted by the Public Company Accounting Oversight Board (PCAOB). Europe should adopt ISA's as soon as possible to reduce uncertainty and promote convergence, and should call for convergence between ISA's and PCAOB standards[436]. Moreover, the quality of the audit work is more and more important, and independence rules are essential in this matter. However, countries currently apply different independence rules, particularly those on scope of services restrictions. Europe should seek to adopt or converge to the independence standards of the International Federation of Accountants (IFAC) as soon as possible[437].

2.2. Creditors

The current financial crisis has underlined some major weakness of European and international financial institutions. In fact, the now intensively publicized world's economic crisis started with a boom on the market of credits and financial instruments. The long period of moderate economic conditions in the European member states and the positive evolution of new member states stimulated this credit expansion and the failure in correctly assessing investment risks. Other factors for the credit boom at international level and for lowering the underwriting standards were: increased competitiveness among financial institutions, low interest rates, rising house prices, and weak government oversight.

As a natural reaction, in times of financial crisis, the attention of bank creditors grows significantly. While in normal conditions, prudence should be a fundamental 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 behavior, 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

---

[435] External Audit Quality and Banking Supervision 2008, Basel Committee on Banking Supervision, p. 2.

[436] Report on the Financial Crisis 2008, drafted by René Ricol, p.57.

[437] Report on the Financial Crisis 2008, drafted by René Ricol, p.58.

the main objective of the companies and funds are primary. However, if loans are not efficiently used, it can lead to bankruptcy.

2.3. Other stakeholders – employees, customers, suppliers

2.3.1. 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.

2.3.2. 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 behavior 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.

3. Importance of communication under economic crisis

Most economic crisis lead to rumors, 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 behavior, if not to optimism, is the communication between the company and stakeholders and between the company and the economic environment as a whole.

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.

In times of financial crisis, communication takes magnitude, since individuals need accurate information on the facts (in order to eliminate rumors 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.

Conclusions

The current economic conditions in the European Union launch new challenges for companies and their stakeholders. 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 some aspects that require changes that may be catalyzed through communication, as an essential instrument of survival and exit from the crisis. The responsibility of managers will be to develop survival strategies and powerful instruments of risk management, whereas investors will be more prudent and conservative. Creditors will tighten their underwriting procedures and auditors will face stricter internal controls in order to avoid audit failures. Confronted with the threat of losing their jobs, employees will become directly interested in the success or failure of the company where they work. In our opinion, the main catalyst of all these changes will be communication.

References

1. Council Conclusions on Five Years after European Union Enlargement 2009, accessed at 08.05.09, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/107540.pdf
2. Council Recommendation on the 2009 up-date of the Broad Guidelines for the Economic Policies of the Member States and the Community and on the Implementation of Member States' Employment Policies 2009, accessed at 08.05.09, http://register.consilium.europa.eu/pdf/en/09/st06/st06638.en09.pdf
3. External Audit Quality and Banking Supervision 2008, Basel Committee on Banking Supervision, accessed at 23.03.2009, http://www.asbaweb.org/E-News/enews-16/Documentos%20Finales/Supervisi%C3%B3n%20Bancaria/SB-01-EXTERNAL%20AUDIT.pdf
4. Feleagă N. 2006, Criza financiară la cumpăna dintre secolele XX şi XXI şi guvernanţa întreprinderii, Economie teoreticã şi aplicată nr. 9, p.61-70
5. Report on the Financial Crisis 2008, drafted by René Ricol, accessed at 20.03.2009, www.experts.comptables.org/csoec/content/download/139505/2840268/version/1/file/FinalReport-def.pdf
6. Rossouw G.J. 2009, The Ethics of Corporate Governance – Global Convergence or Divergence?, accessed at 18.03.2009, www.emeraldinsight.com/1754-243X.htm
7. The Business Environment and Corporate Governance 1998, World Bank 1998, accessed at 25.04.2009, www.worldbank.org
8. This article is a result of the project „Doctoral Program and PhD Students in the education research and innovation triangle". This project is co funded by European Social Fund through The Sectorial Operational Programme for Human Resources Development 2007-2013, coordinated by The Bucharest Academy of Economic Studies.