Crisis Implications over Corporate Governance and Financial Performance

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Abstract

The paper is aproaching a rethoric towards the implications of the financial and economic crisis on the notions of performance and corporate governance. Even though the Romanian economy has overcome the crisis of 2008 – 2010, and today has reached or even surpassed the benchmarcks of the precrisis period, it is important that lessons must learned and the corporate governance should adapt to new shocks.

Key words: corporate governance, performance, financial crisis.
J.E.L. Classification: G01, G18, G34.

1. Introduction

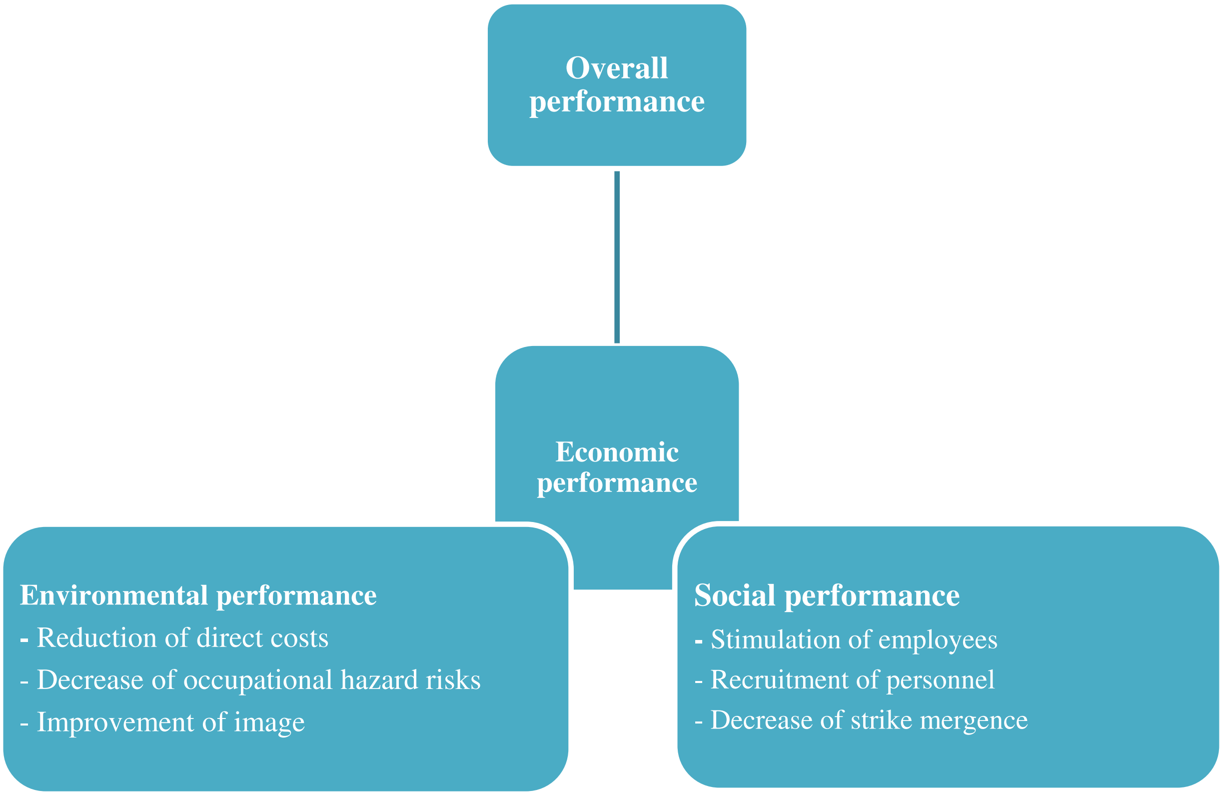
The impact of the financial crisis, has not equally affected the financial performance of the companies. It was noted that not all the companies were affected by the crisis in the same manner and with the same intensity. Recent studies show that risk management and financial policies have had a significant impact over the intensity of the crisis at the level of organizations. Taking into consideration this, we can state that the way in which the company's financial policies are outlined represents the company's way of mitigating, amplifying or cancelling the implications of the crisis over performance. In this respect, the decisions of the Board of Directors and the company's Management, and implicitly corporate governance, have helped the company to overcome the obstacles that emerged together with the onset of the crisis.

2. Approaches to the study of economic and financial performance

According to some authors (Verboncu and Zalman, 2005), performance is a significant result achieved in the economic field involving the efficiency, effectiveness and competitiveness of companies as well as their behavior. Therefore, we can say that a company is not performing in only one direction, but it needs a satisfactory result in all its activities to contribute to the overall performance of the company. Thus, a distinction must be made between the notion of performance and the result. While the result is presented as an absolute value, performance is a relative value since is compared to other values (the preset objectives, the achieved results). In the opinion of some researchers (Albu and Albu, 2005), performance is defined by reference to three important concepts, namely: efficiency, effectiveness and value.

In the opinion of some authors (Reynaud, 2003), "*global performance represents the aggregation of economic, social and environmental performance*," as illustrated in Figure 1, while other authors (Germain and Trebuck) believe that global performance emerged from the reunion of financial performance, social performance and societal performance.

Figure no. 1. Overall performance of the company



Source: own interpretation after Reynauld (2003).

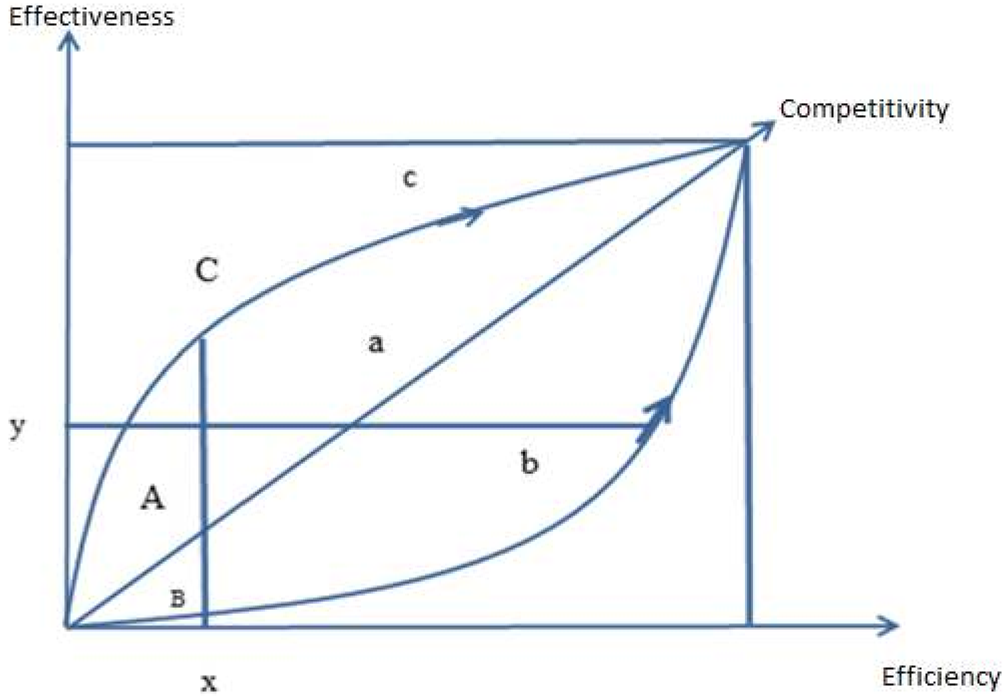
For example, while management attention is focused on the overall performance of the company, current and potential investors are interested in the company's performance in terms of their investments. On the other hand, commercial and financial creditors consider the liquidity and solvency issues important, while employees consider workplace safety as well as flexibility in terms of working conditions.

From our point of view, efficiency and productivity are causes, and at the same time effects that influence performance. While efficiency can be quantified by the level of fulfillment of external factors (customers, state, suppliers, employees and shareholders), productivity is measured by the degree in which the expectations of the company's internal environment are met.

Therefore, according to the Figure no. 2, the point "a" represents the most optimal alternative, due to the fact that it is obtained a balance between efficiency and effectiveness. In the second choice, "b", called "downsizing", the production rate is more intense than the rate of output. Therefore, this means that the enterprise has a good working capacity but it has difficulties in selling the production on the market, the demand being higher than the offer. In this regard, the company needs to pay increased attention to the market side in order to increase the sales. Therefore, in the third choice, "c", called "upsizing", the company registers low efficiency in the use of production factors, as a consequence in providing adequate fixed assets, staff shortages due to staff qualification or fluctuation, or productivity work. Therefore, the company has market power, but it has problems in achieving production according to predefined objectives.

The objective of the companies is to fit in the ideal choice, the "a" choice, but unfortunately, the reality demonstrates that most of the companies fall into the variants "b" or "c". Even if the emphasis is on the efficiency and effectiveness, the company's secondary goal should also consider raising the other variable, otherwise the company risks to have some losses.

Figure no. 2. Representation of financial performance



Source: own interpretation after Jianu, I. (2007)

Therefore, we believe that an enterprise can be efficient, but without being effective. The degree of effectiveness is achieved by the ratio between the results achieved and the results expected by the shareholders and investors. Thus, we can say that efficacy determines efficiency, and not vice versa. In reality, however, companies tend to pay special attention to production, without taking into account the consumers and markets' demands or the renewal of current products with more competitive and up-to-date ones, which leads to a decrease of company's performance.

3. Implications of the crisis over the company’s performance and corporate governance

According to the literature review (Miskin, 2006), the financial crisis represents a disruption of financial markets, whereby issues like adverse selection and moral hazard are worsening, with financial markets not being able to effectively channel funds to those with the most significant opportunities of investment. In other words, the economic crisis is a sudden drop in economic activity (production, employment, investment).

The recent economic and financial crisis began in August 2007, being known in the United States under the name of Subprime Crisis, and then felt its presence in Europe and therefore, worldwide.

The crisis broke out as a consequence of the markets incapacity to self – regulate. Therefore, Nobel Prize winner for economics, J. Stiglitz, states that during the crisis we see how the most favorable free market institutions, from the most significant free market countries, ran to ask for government help and everyone says that is the end of market fundamentalism.

Throughout history, it has been noticed that the economy does not follow a linear upward trend but, depending on the impulses of economic, social or political factors, will increase or decrease by following the phases of an economic growth, apogee or prosperity, recession and depression.

At the level of worldwide economy, the effects of the economic crisis were gradually felt, starting from the US and systematically propagating across the Pacific to the countries called "Asian tigers" and implicitly across the Atlantic to European Union countries and beyond. The effects of crisis on companies and implicitly on their performance have been extensively studied in the specialized literature. Corporate governance can influence performance in terms of amplifying the effects of the crisis or, on the contrary, mitigate or even cancel the effects of the crisis on the company. Thus, good corporate governance, here also discussing an independent and vigilant board of directors, separation of management functions and an efficient reward system between management and shareholders and respect for insignificant creditors and shareholders will help the company to be above the waterline In difficult times.

In economic literature, a number of authors (Brunnermeier, 2009) (Erkens, Hung, Matos, 2012) or (Taylor, 2009) present a direct causal relationship between the emergence of the 2007-2008 financial crisis premises and all the financial and operational difficulties faced by companies. In this respect, a large number of companies either collapsed or needed the government's intervention to be saved, the failure of these companies leading to a freezing of the lending activity and implicitly to a lasting recession in the majority of developed and developing countries.

Although a particular macroeconomic factor has been identified as a devalued monetary policy, it can be said that it invariably affected all companies; however not all companies were affected by the crisis in the same manner and with the same intensity. Recent studies show that risk management and financial policies have had a significant impact on the intensity with which the crisis has been felt at company level. In view of this, we can say that the manner in which the company's financial policies are outlined is the company's way of mitigating, amplifying or canceling the implications of the crisis on company's performance. In this respect, the decisions made by the Board of Directors and company's management and implicitly the corporate governance have helped the company overcome the obstacles that have arisen with the onset of the crisis and its effects.

The analysis conducted by Erkens, Hung and Matos (2012) shows that companies with independent management and a shareholding structure composed of institutions have experienced a wider impact of the crisis on the level of dividends. A possible explanation for this situation can be the fact that shareholders encouraged the company's management to take substantial risks for obtaining consistent dividends.

4. Conclusions

The economic and financial crisis has emerged worldwide after several years of stable economy, with a financial market at its peak and with a high inclination towards investment, fueled by a mix of rational and exuberant expectations. However, interest rates and their volatility were kept at a low level, without much fluctuation. The financial crisis in Romania arose as a result of the subprime crisis from the United States of America. A fiscal policy not convergent with the monetary policy in Romania has also led to an intensification of the financial crisis. The high level of liquidity has caught monetary policy in an unexpected trap, since its regulatory and supervisory roles did not prevent the risks that could affect the economy, implicitly investors. Therefore, **the monetary policy must be combined with the fiscal policy but also with the supervision and regulation into a harmonious relationship** and work efficiently, but these measures could not be met at that time in some of the world's major economies.

Over the years, it has been demonstrated that although there are barriers to markets, they always find their way toward innovation, as well as solutions to meet the demands existing on the market. According to a phrase from the G20 statement, which took place on April 2, 2009, regulation and supervision must keep up with the changes that take place in the market. Therefore, the recent economic and financial crisis did not represent a failure of the markets, but it was, in other words, an impossibility of the supervisory and regulatory institutions to cope with and adapt to the changes that take place in the market.

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