

ANALYSIS OF CONCEPTUAL APPROACHES FOR THE FIRM IN DIFFICULTY

Dan LUPU

Alexandru Ioan Cuza University of Iasi, Romania, Faculty of Economics and Business Administration
Iasi, Romania
danlupu20052000@yahoo.com

Abstract: *Beginning with simple delays in payments until the occurrence of bankruptcy, the notion of a firm in difficulty is extremely complex. The concept involves an economic component, but it cannot be separated from the legal component (for each country, given the legislation feature). Difficult situation of an enterprise requires the existence of vulnerable states in their activities, which upon reaching a critical threshold prevail against the forces of them, leading ultimately to the onset of insolvency process.*

Keywords: *business failure; decision rules; liquidation*

JEL Classification: *G33; G34*

1 INTRODUCTION

Definitions of a company in difficulty vary significantly in the literature. For some authors, the term of Insolvency (Bankruptcy) is used as a general term, which presents companies in financial difficulty (Beaver, 1966; Deakin, 1972; D'Aveni 1989; Hambrick & D'Aveni, 1988; Neumair, 1998; Sheppard, 1994). Other authors consider the term "failed" (failure) equal to that of „bankrupt" (bankrupt) (Altman, 1968, 1984, 2007; Borucki & Barnett, 1990; Cameron, 1987; Ford & Baucus, 1987; Greenhalgh, 1988; Sutton & D'Aunno, 1989; Whetten, 1987; Wiseman & Bromiley, 1996). In all cases, we must keep in mind that bankruptcy is a process that begins financial and ends legal, while failure is not necessarily a legal component (Bickerdyke, 1999; Charitou, 2004; Stiglitz, 2002; Zavgren, 1983).

The exact determined moment of incurrance bankruptcy is hard to say, as the result of subjective decisions within the enterprise is prolonged economic difficulties. In general, legal action for opening insolvency belongs to the creditors; but in practice may exist situations, where for various reasons, they do not start this procedure (Bandopadhyaya, 1994; Blazy, 2004; Claessens, 2002; Prantl, 2003).

Other authors explain the failure from the financial perspective, taking into account the following conditions: negative net assets, cessation of payments to creditors, failure to repurchase the bonds, unable to pay bank loans, unpaid dividends on preferred shares. A company can continue operating in the short term, even in the above conditions. These companies are distinguished by reduced profitability, decreasing business volume, degradation of the social climate, the existence of an external

environment difficult (Argenti, 1976; Balcaen, 2006; Damodaran, 2007; Laitinen, 1999; Ross, 2008).

Next, we present the main views expressed in foreign literature on the definition of a firm in difficulty.

2. AMERICAN APPROACHES OF INSOLVENCY

Edward Altman (2006) defines the difficult situation of a company either financially (the rate of return on capital invested in the company will be less than significant and continuous investment rates similar), legally (when a company is unable to meet its legal obligations to creditors) or in economic terms (undertakings shall cease operations due to bankruptcy or sale of assets). This may be the result of problems initially in the analysis, evaluation and approval of economic financial transactions could not be identified but, throughout the work, and have appeared. The exact moment when the difficulties arise for an enterprise is difficult to distinguish. Difficulties may stem from internal or external causes, both objective and subjective, acting independently or in cross-correlation.

Richard Brealey & Stewart Myers (2007) characterizes the firm in difficulty, based on the seriousness of the situation it faces: economic failure (if the income of a company shall not exceed the total costs, including capital costs); the failure of the firm (situation in which a company has ceased generating a loss to creditors), technical insolvency (current liabilities, as they become due are not met by the firm. The situation involves a lack of liquidity which may be only temporary. However, it gives creditors a signal of a fundamental problem, and they can react to increase guarantees to cover debts); insolvency to bankruptcy (when the total debt of a firm exceeds the market value of the asset sale. This is a more delicate situation than technical insolvency and in most cases; it ends with bankruptcy of firm); default (a term that covers all situations where the company has not fulfilled all contractual terms that lenders have advanced funds or assets of the company. Thus, in this situation include both technical insolvency firms and the insolvent bankrupt); legal bankruptcy (although often use the term broke any case of failure of a company, the legally a firm is bankrupt when: is the failure criteria established by bankruptcy law of the country, has been declared bankrupt by a court).

Edith S. Hotchkiss (2008) defines the situation of a firm being in difficulty depending on the size of the financial risk which it assumes into the economic activity. The difficult situation of an enterprise is presented as "the inability of the company to pay its debts or financial imbalance between funding sources and economic means to be covered in them". Finding such a situation, at a given time, it has the meaning of shortcomings of enterprise risk management in the sense that it was not considered a real prediction of such a condition. If risk management would be called a provisional analysis of the economic and financial situation of the company, it would have the effect of taking some progressive measures of the firm's recovery.

Stephen Hillegeist (2004) points out that the concept of an enterprise in difficulty is questionable reducing it to purely financial aspect of suspension of payments or financial imbalance. Motivation should be given to the causes underlying the difficulties

that may be encountered by an enterprise, they have meanings economic, financial or / and juridical. The causes difficulties can be connected thereby to any of the aspects of the entity. It may be related to production quality and volume, the technological level of fixed assets and their physical wear, mechanisms regulating the markets and / or supply of human resources of the quantity, but also quality and even priority, the quality management process.

3. FRENCH APPROACHES OF INSOLVENCY

Pierre Vernimmen (2005) considers bankruptcy as the main instrument for reallocating inputs from the inefficient to the efficient firms. Every economic system needs mechanisms to ensure optimal use of resources. Theoretically, bankruptcy shades bad apples " from the distressed sectors and allow profitable groups to thrive. Without effective bankruptcy, financial crises would be longer and deeper. The bankruptcy can allow a company to reorganize, often requiring asset sales, changes of ownership and partial debt forgiveness from creditors. In other cases, lead to bankruptcy, liquidation, company death. Bankruptcy is triggered when a company cannot meet its short-term commitments, and thus face a liquidity crisis. However, the exact definition of financial hardship / bankruptcy may differ from country to country. Bankruptcy is a critical moment in the life of the company. Not only bankruptcy requires that each of the company's stakeholders to make specific choices, but the very possibility of bankruptcy has an impact on investment and financing strategies of healthy societies.

Bernard Colasse (2008) defines bankruptcy through the financial-economic equilibrium based on balance sheet indicators. The risk of bankruptcy, default or illiquidity, is a major risk because, unlike the risk of loss, he is legally sanctioned, a loss-making company can continue its activities as long as she is able to pay its debts rather, the fact that the payments cease her to enter into a legal process that could lead to its disappearance. Termination payments is considered in which the company unable "to meet its outstanding liabilities with assets". This state triggers a regulatory procedure that means financial bankruptcy court. According to established expression, the firm must to "deposit balance" at the court's jurisdiction. Following the judgment, which gives the judicial settlement, depending on the seriousness of the situation, there are two possible scenarios: recovery or liquidation. Even when you can complete in a recovery, the bankruptcy has bad consequences on owners, creditors, employees and managers, recovery may involve, indeed, final losses for owners abandonment of claims of the lenders, a reduction in the number of employees and changes in the management team.

Bank of France (2003) established that the strict definition of the state of financial difficulty, however, is not a weakness, because the manifestation in one way or another of the other functions of the company (production, trade, human resources, etc) propagates on the financial situation of the company. Into the company's activity, the payments stop to creditors is the final result of the problems it has.

An enterprise may have temporary difficulties caused, for example, by a claim within uncovering important or acceleration of payments in a period of economic growth in the case of payment difficulties is the expression of a financial imbalance which must

not jeopardize the balance economic and financial fundamentals and does not affect economic activity and image of the company in a great extent. Permanence of payment difficulties obligations expresses deep economic and financial vulnerabilities, formed over a longer period, which can generate serious cases, loss of the business.

4. LEGISLATIVE APPROACHES OF INSOLVENCY

Given the importance of the firm in difficulty for the business environment and the generated implications, this concept is largely discussed into legislation.

The European Community legislation (Regulation EC No. 794 of 2004 European Commission on state aid) defines enterprise in difficulty as follows: when the firm is unable, either through their own resources or the resources that they can obtain from its owner / shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will lead, in the short or almost certainly out of the economic market.

Specifically, a firm is regarded as being in difficulty, in principle and irrespective of its size, in the following circumstances:

(i) for enterprises of any legal form, when such organization meets the conditions to be subject to proceedings under the law on the procedure of judicial reorganization and bankruptcy.

(ii) for a limited liability company, when the cumulative conditions are fulfilled: the loss of 50% of the share capital and 25% is lost in the past year;

(iii) in the case of a company where at least some of the partners have unlimited debts to enterprise, when it has lost more than half of its own capital, as shown in the accounting records of the company and more than a quarter of capital has been lost over the preceding 12 months.

In Romania, the *Law No.85 of 2006 regarding insolvency proceedings* defines insolvency as the state of the debtor's assets, characterized by the evident failure of payment of debts due to the amounts of money available.

However, Romanian law distinguishes between the following concepts:

- Financially difficult situation (involves termination payments and the businesses they mainly cash difficulties. They are economically viable, but disregarding economic and financial balances, management mistakes, are healthy businesses, but vulnerable. If not proceed to reorganization measures, such enterprises are vulnerable by itself assuming risk of cessation of payments).

- Bankruptcy (in legal terms means the procedure whereby a company declared insolvent, will liquidate and stop economic activity. Bankruptcy is declared failure criteria established by legislation, and in financial terms can mean negative net assets, cessation of payments to creditors, failure to pay dividends on preferred shares).

The Law nr.381 of 2009 regarding the concordat characterizes the firm in difficulty as „the firm whose managerial potential and economic viability are in decreasing dynamics, but whose owner runs or is capable of performing duties due”.

This definition leads to many difficulties in practice for both the borrower (who needs to know the precise moment when his company is in difficulty, so you can request

the opening of proceedings or appointment of a trustee arrangement ad-hoc) and for the bankruptcy judge (who for to approve an arrangement, the borrower should note that the company is in difficulty).

An enterprise is considered to be in trouble if either of their specificities, such as: decreased turnover / net asset value / treasury or increase debt / loss / excessive inventory / tax obligations. In all cases, an enterprise is considered to be in trouble if he cannot recover, either with its own resources or with the funds it is able to obtain from its owners / shareholders or the market.

In order to be applied to ad-hoc mandate procedure or concordat, the company must either be characteristic of distressed company (ie the loss, turnover declining stocks too high, high debt and declining or negative net asset) or fails to recover its own resources or with funds provided by the owners / shareholders in the short or medium term is in danger of going out of business circuit, that disappears as the enterprise with adverse consequences on its stakeholders.

In Table 1 we have summarized the main definitions used in the literature.

Table nr.1 Definitions of enterprise economic difficulty in the literature

Author	Terms used	Definition
Altman	Bankruptcy	Those companies that have been declared legally bankrupt, have been declared insolvent or later approved reorganization
Bank of France	Defaillance	Registration at court of the bankruptcy demand
Beaver	Failure	The inability of a firm to pay its maturing obligations: inability bank loans or debentures along with the withdrawal of donor support, failure to pay dividends on preferred shares
Conan & Holder	Defaillance	Inability to pay debts into liquidation proceedings or an explicit agreement with creditors to reduce debt
Colasse	Defaillance	Defines bankruptcy through the financial-economic equilibrium based on balance sheet indicators
Deakin	Failure	Company entering in liquidation proceedings, insolvency or other reorganization
Elam	Bankruptcy	Reorganization under Chapter XI of the Federal Bankruptcy Act, consent of the shareholders to reorganize under bankruptcy law
Ohlson	Failure	Bankruptcy is defined as the business was liquidated following a court ruling
Taffler & Tishaw	Failure	Bankruptcy is the default entry, voluntary or forced liquidation based on the decision of the court or government action
Vernimmen	Defaillance	Defines bankruptcy as the main instrument for reallocating inputs from inefficient firms to the effective
Zmijewski	Failure	Specifying the conditions preceding bankruptcy: impossibility to pay current obligations, lack of financial resources for repayment of loans, collection of very late the counter products delivered, recording losses

Source: Anghel, I. (2002). *Bankruptcy. Radiography and prediction*, Ed. Economică, Bucuresti, 2002

CONCLUSION

From our point of view we propose the following definition of enterprise in difficulty ”firm in difficulty is the company facing a lack of liquidity and difficulties

arising from the fulfillment of obligations outstanding financial previously contracted necessary for smooth running of its activity”.

The failure of a company is going in a certain period of time but may be the consequence of absolutely random events that the company failed to respond adequately. So, as stated in the literature, each firm has ”its own way to bankruptcy”.

Despite numerous definitions in the literature, it is worth noting, however, some essential concepts defining enterprise in difficulty: economic failure or firm insolvency or bankruptcy technique. Regarding the causes of the difficulties for the company, we believe that they can take many forms which frequently have a negative impact on performance to both internal and external forms.

It is wrong to say that a business with difficulties, economic or financial, is bankrupt. Bankruptcy is the final stage of a long evolution of economic and financial deterioration of the company, and is necessarily a legal constituent.

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