The Leadership Styles and the Financial Problems in Romanian's Companies

~ Ph. D. Teaching Assistant **Valentin Mihai Leoveanu** *(Faculty of Administration and Business, University of Bucharest, Romania)*

E-mail: valentin.leoveanu@faa.unibuc.ro

Abstract: *New business models no longer rely on expectations of increased consumption, but rewarding the saving of resources and penalizing the waste of them. Businesses based on stable cash-flows rather than speculative businesses are the ones that survive in times of crisis. The current economic environment is characterized by several features, namely: consumers are more careful with spending and seek substitutes for expensive products; economic downturn trend creates the need for new products and services such as adult education or corporate data security; consumers are looking for and choose products that provide the best value for the money spent on them. Economic and financial failure of many Romanian companies has been highlighted in recent years by the evolution of their insolvency, as emphasized the research leads by Coface Romania: the coverage of deteriorating equity was made by attracting additional debt; attracting capital was made especially over short terms with the suppliers credit; more than half of long-term investments were unprofitable; constant increase of the average day's sales in receivables showed an inadequate policy of commercial risk. In this context, it is important to reveal how leadership styles applied in Romanian companies has led to the development and worsening of their financial problems. The main issues relate to selective rotation pay providers according to the volume of transactions, business relations history, future interests or, simply, bargaining power and importance of each supplier.*

Key words: leadership styles, leader's personality, aims of the leader, relations with followers, leader's behaviour, organizational culture

JEL Classification: G30, G32, G35

1. Introduction

The analysis included in this paper aim to reveal the link between the leadership styles that could be encountered in Romanian's companies and the companies financial evolution, how strategic thinking of Romanian managers could save or destroy financially a business in times of economic distress.

The study reveals its importance by highlighting the link between the behavior of a company manager, such as a financial manager, and the financial status of that company and how the leaders of the company could influence its financial wealth.

Methodology of research was based on searching and analyzing the results of specific researches in the field of organizational and managerial practices linked to the Romanian cultural values and behaviors. Taken into consideration the researches of Romanians consultancy companies and a series of specialists in Sociology and Psychology, the paper try to find connections between the way of thinking and behavior of managers of Romanian companies, their reference values and business model and the financial results of the company. In this respect, it is a valuable outcome to find out to what extent Romanian managers act as leaders in their companies and how much their decisions and actions influence the company financial status.

The results of research are highlighted by showing the strengths and the weaknesses of Romanian companies leadership, the links between management and leadership in Romanian companies and the actions to be taken by Romanian leaders in order to adapt the company activities to the demands of the future evolution of markets.

2. Literature Review

There are many theoretical approaches and opinions about leadership styles, among them, the present article consider authors like Daniels (2004) and Davies & Brundrett (2010) who appreciate that there are four categories of leadership such as:

a. Autocratic Leadership – is based on the concept that the leader knows best and on unidirectional communication to the lower hierarchical levels; leader behaviors are characterized by controlling, being directive, taking decisions and solving problems by himself; impact on employees is reflected by rebellion, hostility.

b. Consultative Leadership - is based on the fact that the leader informs employees about the best ideas; behavior characteristics imply directive approach, holder of information and advisor; impact on employees supposes an increase of knowledge.

c. Participative Leadership – is based on the premise that every employee has to come up with proposals and communication is free, open and mutual; leader acts as facilitator, is a person who holds and shares resources, encourages the active participation of employees; effect on employees is reflected in improved productivity, widening opportunities for professional development, increased cooperation and teamwork;

d. Laissez-faire leadership - leadership responsibilities are assumed by the group, behavior within the group is permissive; it supposes passive approach, provides support and limited feedback, does not set limits; effects on employees can be seen in the failure to accomplish the tasks, ignoring relationships between group members and apathy.

There are many debates regarding this classification. Dukakis et al. (2010) reveal that there is a negative impact of autocratic leadership in private companies from the public ones reflected by the level of revenues.

Davies and Brundrett (2010) consider that the application of autocratic leadership in time of crisis or high risk is welcome and efficient to achieve the objectives.

By other authors, a classification of leadership in various categories is not practical (Schermerhorn et al., 2011 and Griffin, 2011) because each leadership situation is different regarding its various and unique circumstances and classifying different types of leadership into rigid moulds would not be appropriate for practical reasons.

Another approach of leadership styles was made by Badea (Badea, 2011) that highlighted the timeline of different models of leadership. Leadership is the creation of consensus, guiding employees by psychosocial processes - communication and influencing - for carrying out the activities (Tannenbaum, Weschler and Massarik, 1961). Some authors have put to the forefront the leader's personality (charisma) and his personal qualities - the theory of big men, based on a social, elitist philosophy (Machiavelli). In the late 80s, grows a new type of leadership, charismatic leadership (Conger and Kanungo, 1988) that express charisma not as an attribute, but as social relationship. Another model in the same meaning is transactional leadership (Hollander, 1987). According to this thinking, leadership is a transaction (a mutual influence), a social exchange between leader and subordinates, which implies influence and counter-influence. Cooperation is developed through negotiations and loyalty could be bought with reward to employees (Bass and Avolio, 1993). At the end of the twentieth century a new model arises: transformational leadership model, strongly centered on individual consideration and intellectual stimulation. Transformational leaders have the ability to recognize the need for change, to build a vision and focus on it, to pursue worthy goals and to bring together people to work cooperatively to achieve the desired goal or the assumed change (Gillis, 2005).

While management can be defined as the process of coordinating human, informational, physical and financial resources to realize the goals of the organization (Reece and O'Grady, 1984), leadership emphasized human resources, especially the person as a distinct entity, and his/her intellectual and emotional transformation in relationship with management and other resources in order to accomplish the final goal, objective of the organization.

3. Leadership styles and financial manage-ment of Romanian's companies

Corporate finance theory highlights some important rules for the financial viability and sustainability of a company. In this respect, ensuring long-term and short-term financial equilibrium, that means maintaining the solvency of the company, ensuring an optimum ratio between risk and return on investments, an adequate management of cash-flows and compliance with a sustainable level of indebtedness are the pillars of a successful company from financial point of view.

It is obvious that all these issues will be considered depending on the specific business, its seasonal or cyclical features, the stage of its life cycle, as the economic environment in which that company operates.

Providing financial equilibrium to company implies the existence of a working capital, absolutely a positive value, in order to finance part of current assets through long-term resources. Working capital reflects also the full coverage of long-term assets by long-term resources such as equity and long-term liabilities which is the core of financial solvency of the company. The solvency of the company is defined as the company's ability to cover all debts by total assets.

In the same context, maintaining an optimal balance between the profitability of operations or projects brought by investments and the associated risk should lead to maximize the value of the company, i.e. the wealth of the company owners, that is the primary goal for financial management.

Effective management of cash flows is achieved by registering positive values for cash balance, corresponding to the main three activities or functions involved: operational, investment and financing.

In terms of operational cash flow management, the premise is the existence of a positive value for working capital, that is seen as the difference between current assets and current liabilities, and which is no more than a long-term security margin supported by long-term resources.

As a result, each component of working capital - receivables, inventories and trade payables - should be managed carefully in order to minimize the resources allocated at any time to maximize sales and customer satisfaction.

The financial manager will have to take into account any fluctuations in working capital as conditions change in operating activity. These changes refer either to a depreciation of stocks or an increase in their cost of storage, either to a too large extension of the period for granting customers credit. In this regard it will be monitored measures such as granting discounts, supplementing the sales of stocks or temporal extension of contractual claims and their effects on receivables or customer satisfaction.

From the perspective of long-term financial management, the financial managers will take into consideration the return and risk associated with equity investments made by the company and their choice on the sources of financing based on weighted average cost of capital and the level of indebtedness of the company. These two components - the investments and their funding - influences the liquidity of assets and the payment term of liabilities and also operational cycle need to secure additional working capital, with important effects on financial balance of the company and the company cash flows.

The above considerations are related to financial management that is seen as a way of management from financial point of view; it is oriented towards creating value for the owners of that company, increasing their wealth in the company. As such, financial management aimed to get pozitive financial results, to elaborate and manage budgets and processes, to plan, to organize and to control financial oparations.

In contrast, leadership means something else because it aims to guide employee towards a common vision, focusing on change, motivation and development. So, while maximizing results is the prerogative of financial management, leadership is oriented to maximize people's motivation and satisfaction on their development within the company (J. Kotter, 2008).

In this regard, it is important to reveal the results of a research conducted by a consulting company named Result Development. The research was undertaken between February 2009 - March 2011 and considers the views of 110 Romanian managers of the 72 companies - 45 multinational and 27 national companies - on investigating patterns of thinking and behavior, cultural and educational trends and their impact on managerial decisions and actions (Badea, 2011).

The research highlighted the following aspects:

• deficiencies in collaborative relationships between top management and middle management

• manager orientation to problem solving, and on the other hand, short-term focus on the present and less on developing a long-term sustainable performance

• need for integrity, communication and support

• management trend toward intuitive, inspirational, emotional

• strong focus on the present and on getting immediate satisfaction and results

• commitment and dedication to company quantified by overtime work

• low confidence in leadership, motivation tools and involvement of employees

• Regarding the analysis of differences between national and multinational companies the study has shown that there is a much stronger orientation in multinational companies on getting profitable on long-term. The Romanian managers of multinational companies values to a greater extent leadership and strategic thinking, while managers of national companies are more classical oriented towards managerial functions.

Another research conducted by a consulting company named Interact (Luca, 2005) shows two styles of leadership in Romanian companies:

• Family entrepreneur, for which important are family interests, personal wealth, current profit, possibility of risk and adventure, and ultimately the increase of the organization

• The Founder managing style - in the western region (under German influence) - who acts and feels responsible for the employees and for the the company and wants to create something new, is a risk taker and is interested in adventure, business continuation, honor and reputation.

Both styles need to exercise closely supervision of subordinates and to have skills or inclination for strategic planning.

Romanian employees has a high need for power approach, they need to be treated with trust, to receive permission to freely express their fears and even to be allowed to avoid decisions that seem too risky to them. They also want to have a leader who assumes sometimes those risky decisions on their behalf and who provide support if they try something different.

In Romania it is difficult to delegate responsibility to lower hierarchical levels because employees do not feel comfortable knowing that they have responsibility for the decisions they take, without having a set of procedures to support them in times of difficulty as exists in the case of the German leadership. Many Romanian employees can reach a state of paralysis and inaction as a result of delegating authority and sudden power distribution or they will use this discretionary and only in personal interests or their group interests (Luca, 2005).

The leader who succeed to make changes and to communicate continuously in order to pave the path of changes will have much success in employee engagement on this path. Changes must be communicated well in advance, with great preparation and minimizing risk to ensure that everyone understands the future direction (Luca, 2005).

Each new change is considered as a problem and an additional stress, even if in the end it turns out that saves effort and increase efficiency. Romanian employees are not excited about the new technological releases and they are not willing to increase the speed of how things are done in the company; instead, multiple changes and process improvements born feelings of fatigue and despair (Luca, 2005).

4. Financial distress of Romanian's compa-nies after financial crisis

The international financial crisis has left deep traces in European economies, which influenced the development of the Romanian economy. Its influence manifested primarily by decreasing access to bank financing of Romanian companies, and secondly by reducing or even disappearance of certain markets for different segments of economic activity. Romanian companies have been negatively surprised by these developments and, as such, the company management had to be taken vital decisions for the company's operation and to apply drastic and urgent measures in this regard.

Financial management has represented and represents a decisive factor in the process instrumentation of adapting the business plan to macroeconomic changes. Taking wrong financial decisions or, even worse, indecision or inaction of financial management can lead a company in the last stage of his life, namely insolvency and bankruptcy.

In this regard, Coface Romania, the Romanian branch of the well-known credit insurance company from France, performs periodic reports and researches on financial evolution of Romanian companies.

In the study named "Panorama România Insolvențe" from January 2015 (Guda, 2015, p.16), there is a detailed analysis of the profile of insolvent companies and the causes that lead them in insolvency proceedings. Evolution of Romanian companies that entered into insolvency in 2014 was based on the following stages:

Stage I: 2009 - 2011 was marked by destabilizing companies capital structure, losses was not covered by equity, long-term investments with negative yield were financed by short-term resources and there were an increase of the extention of receivables.

Stage II: 2012 - 2013 was marked by falling sales, gain losses and increase the average duration of receivables.

The branch distribution of insolvent companies highlights the following aspects (Guda, 2015, p.5, 7):

• economic activities which registered the highest number of insolvencies were those on retail (23%), wholesale and distribution (17%) and construction (15%);

• there was a significant decrease in insolvencies recorded in 2014 compared to the previous year, but only statistically, because the decrease of the number of insolvencies is found in proportion of 36% among companies that still do not carry out any activity (turnover recorded nil in 2013), while 43% of insolvencies decrease is recorded among companies with a turnover below 100 K EUR;

• analyzing the phenomenon of insolvencies compared to developments registered in similar countries from Central and Eastern Europe, Romania registers a very high incidence of insolvencies reported to the number of active companies.

As an important cause for the evolutions presented above, the inappropriate analysis of cash-flows was leading to the insolvency of profitable companies that would be able to avoid this situation. If the company does not have liquidity, profit has no value, such as liquidity was a central issue of the financial crisis started in 2008, and the number of companies liquidated, insolvent or bankrupt increased from one year to another.

Another important factor was the decisions taken by banks in order to maintain a low level of working capital financing, so that cash-flow and liquidity remained vital issues for any company.

Some managers have gone from one extreme to the other, so when they ordered financial funds, they sought to quickly pay some of the debts, without taking into account the liquidity required to continue operations and generate new revenues. This new generated revenues are the main factor that, in time, brings real value to cover new generated debts. An analysis of cash-flows (when, how and what to pay, respectively, when and why the company needs cash) is therefore vital for Romanian companies.

Another aspect that has caused financial problems was a poor management of commercial contracts. An example is the failure to collect advance payments for larger or customized work and subsequently the company risks to remain with unpaid invoices, which sometimes can be fatal.

On the other hand, the Romanian companies must be always careful to cope with an unstable regulatory environment concerning accounting and taxation; those kind of regulation have a major impact on companies cash-flow in a very short time after their enactment.

The lack of predictability regarding legislative regulations and strategies of the government is an old problem that the business environment in Romania must face it and it affects both domestic companies and foreign investors.

According to the Coface Romania Report (Guda, 2015, p.14, 17) there were some additional factors that destabilized the financial structure of the companies that became insolvent in 2014, namely:

• a more rapid growth of receivables to the increasing turnover - is one of the unsustainable financial trends for the company, leading inevitably to a decline in liquidity and the collapse of production;

• raising short-term debts from suppliers to be invested for the long term - this is a wrong decision that is against the theoretical and practical approaches about the rules of funding of a company;

• long-term investments were unprofitable, so companies amplified their losses from year to year - that has proved inadequate selection of projects and a wrong vision about the future trends of markets;

• steady increase of the average day's sales in receivables - indicates an inadequate commercial risk policy which led to deferred payment of suppliers (increase the average day's sales in payables).

Regarding micro-enterprises in Romania, a Coface Romania Report entitled „Radiografia microintreprinderilor din Romania" (Guda, 2013, p.2-3) highlights the following issues:

• they recorded the highest level of indebtedness 99% (as a percentage of total debt to assets)

• they are the only economic branch which recorded a negative capitalization in the last years

• they have the highest rate of loss, respectively -4.5%

• they recorded the highest day's sales in receivables (172 days) that the one recorded before financial crisis

• they have the lowest percentage of total debt coverage by turnover, 37%

The analyses conducted by Coface Romania raise an alarm on future developments of Romanian companies that have to face with growing financial problems. Therefore, they are especially stressed three consequences on the national economy: the increase of the number of annual insolvencies; the slowing-down of economic regeneration by the naissance of new businesses, that means new registered companies; the increase of bad loans.

5. Conclusions

Status of financial difficulty of a company is defined in economic theory as a crisis situation that could become dramatic by restriction of activity, reducing loans etc.

General aspects that lead to the identification of companies in difficulty are expressed through: insolvency; indebtedness; the existence of a negative working capital or even a negative result; use of existing loans to finance investments; renewal unable credits; failure of suppliers or customers etc.

A company in distress is a company in disequilibrium on industrial, social and financial levels and they are characterized by: maladjustment to the environment, decrease workload and profitability, the use of poor management techniques and tools, low use of production capacities.

The causes that generate difficulties for companies are diverse and come largely from socio-economic and competitive environment in which the company operates, while the others have domestic nature.

Among the internal causes are: lower inventory turnover and receivables turnover comparing to the standard practice of the economic field; a margin below the standard practice of the economic field; investment financing by sources related to operational activity; recurrent losses from operation; failure of credit renewal.

As specific causes linked to the management and leadership there are:

• inadequate professional training of managers and inability to adapt to market conditions;

• disagreements between managers from different levels

• failure of management accounting

• excessive remuneration of managers

• the existence of incompatibilities with the position of manager of the company

Financial management is a set of concepts, techniques and tools that provide the analysis of internal and external information in order to assess relevant statements on the financial situation of a company and for taking decisions on short and long term on the company's activities.

Unlike management, leadership aims to guide employee towards a common vision, focusing on change, motivation and development.

In this respect, it is important to influence the achievement of positive results in financial management by leadership using both working tools and psychological tools of leadership, as presented below (Badea, 2015).

Working tools of leadership on Financial Management correspond to the followings:

• to have a good level of liquidity

• to reduce operational costs

• to continue to invest in the medium and long

• to focus on products / services involved (and sell what is non-core); to exit from falling markets

• to focus on major customers (to retain customers and to select carrefully the new ones)

• to develop excellent relationships with suppliers (including banks)

• to make decisions quickly and take action immediately (to manage risks better)

• Psychological tools of leadership on Financial Management refer to the followings:

• to invest in training programs for employees to cope with financial problems

• to keep employees informed on managers decisions and actions

• to establish a process of changes

• to implement a schedule of changes and development

• to motivate and stimulate others through informal actions

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