

FACTORS CAUSING BANKRUPTCY IN THE CORPORATE SECTOR

¹VALUTA Gabriela, PhD student

e-mail: gabriela.valuta89@gmail.com

²MUNTEAN NELI, PhD, associate professor

e-mail: nelimuntean8@gmail.com

^{1,2}Academy of Economic Studies of Moldova

61 Banulescu Bodoni Street, 2005 Chisinau, Republic of Moldova

Web page: www.ase.md

Abstract. *The institution of bankruptcy is necessary and obligatory in any market economy. In most cases, a company's bankruptcy is determined by the simultaneous effect of several causes, both internal and external. This problem has a significant importance in the field of the management theory and practice, internal planning and control of the enterprise. The study of different approaches regarding the factors causing bankruptcy identification is characterised by a large variety of theoretical and applicative approaches. It is impossible to formulate some recommendations of bankruptcy analysis or/and assessment in corporate sector without knowing the justified essence of bankruptcy causes. In the work hereby, some aspects of the causes of bankruptcy in the corporate sector have been analysed. To achieve the purpose of the research, the dialectical method with its inherent processes were used. The presence of these aspects of scientific investigation gives the article originality and update.*

Key words: bankruptcy, corporate sector, factors, external, internal.

JEL CLASSIFICATION : O17, B5, M410

INTRODUCTION

Bankruptcy is an indispensable part of every entity tending to meet the demands of the market economy, irrespective of the activity profile, legal form, dimension and socio-economic space where it activates.

Nowadays, the problem regarding the factors that may cause bankruptcy is actual and much discussed theme in market economy. The bankruptcy of a company has negative impact on all subjects in relationship with this entity. Possibility of evaluating and estimating the factors that may influence on bankruptcy in corporate sector is an advantage for all external and internal users. Based on the assessment and identification of general factors of bankruptcies, companies are able to take necessary corrective action in time.

On July 24, 2020, the Public Services Agency of the Republic of Moldova in the Official Gazette no. 188-192 (7516-7520) published the opinion announcing the list of legal entities automatically removed from the State Register of legal entities whose activity was suspended. The published list contains the names of 968 companies, LLCs and individual entrepreneurs.

Therefore, it is important to outline the problems and the main bankruptcy causes at the level of the companies. The objective of this research is to study the different approaches regarding the factors causing bankruptcy in the corporate sector. It is impossible to formulate some recommendations of bankruptcy analysis or/and assessment in corporate sector without knowing the justified essence of bankruptcy causes. In the work hereby, some aspects of the causes of bankruptcy in the corporate sector have been analysed. To achieve the purpose of the research, the dialectical

method with its inherent processes were used. The presence of these aspects of scientific investigation gives the article originality and update.

LITERATURE REVIEW

The problem of bankruptcy and its explanatory factors are widely debated in the literature. It is important for policy-makers to know the causes of bankruptcy, in order to implement measures to increase the efficiency of restructuring, insolvency and discharge procedures. The literature on bankruptcy has typically focused on the prediction of bankruptcy risk. Therefore, it is worthwhile to analyse the causes of bankruptcy. Ooghe and De Prijcker (2006) [8] presented a general bankruptcy cause model that distinguish four main types of failure processes: unsuccessful newly established companies, ambitious growth companies, dazzled growth companies and gradual deterioration of established companies. Their findings of bankruptcy causes were based on a case study of bankrupt of 12 Belgian companies. Nevertheless, these causes can be generalized as universal bankruptcy causes. In addition, Ooghe and Waeyaert (2004) [7] suggested a 'conceptual failure model', in which they differentiate five intertwined groups of external and internal causes of bankruptcy. Euler Hermes Kreditversicherung and the Centre for Insolvency and Reorganization at the University of Mannheim published another comprehensive study of bankruptcy causes in Germany in November 2006 [4].

This study clearly shows that a typical case of a bankrupt German company would be caused by a mix of bad financial management, no/poor controlling, and an authoritarian leadership style, not necessarily recently established. Another analysis of bankruptcy causes in Germany is based on the studies of Wieselhuber & Partner. The research of Wieselhuber & Partner confirmed and approved Euler Hermes Kreditversicherung and the Centre for Insolvency and Reorganization study results. The two presented German studies have coherent results and denote poor management as a primary origin of business failures in Germany.

Branko Novak and Domagoj Sajter, 2007 [1], have done very few systematic researches in the field of bankruptcy in Croatia. They found out that in Croatia the highest responsibility for success, as for a bankruptcy, lies in the field of management, much like in the rest of Europe. Also worth mentioning are the models of Dyrberg, Lee and Grunert (Dyrberg 2004; Lee et al. 2003; Grunert et al. 2005), [2,5] the main advantage of which is that these models are related to macroeconomics factors, business sector or corporate governance.

In Central and Eastern Europe, due to, among other factors, the geopolitical situation and the introduced economic system, the institution of bankruptcy began to function and became the subject of researcher interest in the first half of the 1990s.

RESEARCH METHODOLOGY

This paper seeks to answer the following question: What are the factors that may cause corporate bankruptcies? Therefore, the objective of our research approach was to analyze the level of research in the field of bankruptcy causes in accordance with the latest global research trends. For this purpose, the method of analysis of the scientific literature was applied. The publications chosen as the research base were mainly selected from the Google Scholar and ResearchGate databases. Moreover, the work hereby presents and provides an introduction in this research area. This study is one of the few researches that involves the analysis of the scientific literature in this area of research.

RESULTS AND DISCUSSIONS

According to the literature review, it is not possible to designate a single reason that would be 100% responsible for bankruptcy of a company. The failure of a firm is the result of a whole set of factors, factors that often overlap with each other, even if their sources of origin are different - endogenous and exogenous. That is why the correct identification of the factors is the basis for an efficient management. This approach allows us to determine the bankruptcies causes of a company.

By content, these factors can be grouped according to their sources of origin as **follows**:

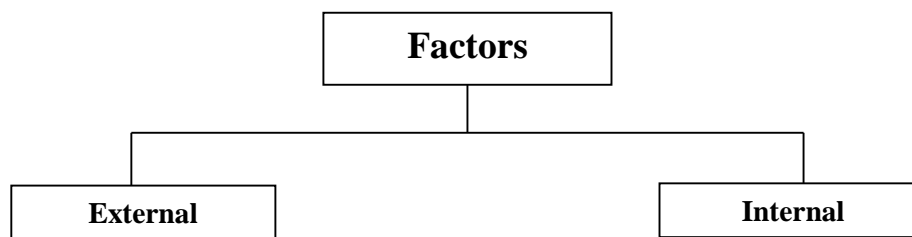


Figure 1. Factors causing bankruptcy in the corporate sector

Source: author compilations

Usually, **external factors** do not depend directly on the entity; they are the result of exogenous causes related to the general economic situation of a country: inflation, anarchy, political and economic crises, ecology, customs duties, and the existence of a more favourable regime. They are factors over which the corporate sector cannot have a direct influence, but whose significant change can be predicted or can indirectly influence the bankruptcy of a company. It is possible to delimit the factors that affect all or almost all companies in the same way and the factors that influence only certain companies or the factors that oppose different groups of companies in the opposite way.

Neli Muntean (2019) in the monograph "*The analysis of financial stability in the corporate sector*" [6] delimits four segments of external factors, each with direct and indirect influences on the results of the activity of the corporate sector, respectively:

1. The first segment refers to *political factors*. As for political factors, they incorporate the sovereignty of nations, legal systems, government policies, philosophies, interest groups, political parties. Some of these factors can affect the entire corporate sector, for example, changes in tax legislation. Others - only a small number of entities, for example, antitrust laws. However, they are essential for public interest entities, for example, the alignment of political forces or the results of elections. However, to some extent, directly or indirectly, political factors influence all entities.

2. The second segment consists of *economic factors*. Economic factors refer to general economic conditions (growth, unemployment rate and GDP), monetary policy factors (interest rate), consumer price factors (consumer price index and inflation), factors related to international operations (exchange rate), largely influencing a country's business environment.

3. A rather important segment is that of *social and cultural factors*. N. Muntean in her work delimits the following sociocultural factors that the entity most often faces: birth rate; mortality; the level of immigration and emigration; life expectancy index; income level; lifestyle; educational standards; shopping habits; attitude towards work; attitude towards rest; attitude towards the quality of goods and services; the need to control environmental pollution; energy saving, attitude towards government; interethnic problems; social responsibility; social welfare.

4. Finally, it is necessary to highlight the segment of *technological factors*. Considered the main engine of an expanded production - social progress. Revolutionary technological changes and discoveries in recent decades, such as robotics, the penetration of computers into people's daily lives, new types of communication, transportation, weapons, and more, are both great opportunities and serious threats to them, whose impact managers need to be aware of and which they need to assess. Some discoveries can create new industries and close old ones.

At the same time, considering the global impact of the COVID-19 pandemic, I consider appropriate to supplement the number of segments with the *Biological Factors Segment*. The fifth segment is currently a novelty factor for the economy not only of the Republic of Moldova, but also worldwide. The crisis caused by the pandemic has so far increased the number of closed companies by about 60%. Many large companies worldwide are announcing their bankruptcy. On July 24, 2020, the Public Services Agency of the Republic of Moldova in the Official Gazette no. 188-192 (7516-7520) published the opinion announcing the list of legal entities automatically removed from the State Register of legal entities whose activity was suspended. The published list contains the names of 968 companies, LLCs and individual entrepreneurs.

Internal factors also have a significant influence on bankruptcy. Internal factors from several points of view directly characterize the entity: productive potential, technical assurance, level of intuitive and technical specialization, work organization, choosing the type of contracts with investors or customers. At the same time, internal factors are those over which the entity can directly exercise influence. Therefore, according to the analysed literature, can be distinguished the following internal factors that can cause bankruptcy in the corporate sector:

1. human potential,
2. the technical-material potential,
3. financial potential etc.

Their cumulative impact on bankruptcy in the corporate sector depends not only on the relationship between factors, but also on the stage of the production cycle in which the entity is the competence and professionalism of its managers. Practice shows that a significant number of failures of an entity may be due to the inexperience and / or incompetence of managers, their inability to take into account changes in the internal and external environment.

CONCLUSIONS

According to the literature review, it is not possible to designate a single reason that would be 100% responsible for bankruptcy of a company. The failure of a firm is the result of a whole set of factors, factors that often overlap with each other, even if their sources of origin are different - endogenous and exogenous. External factors do not depend directly on the entity; they are the result of exogenous causes related to the general economic situation of a country. Neli Muntean (2019) in the monograph "*The analysis of financial stability in the corporate sector*" [6] delimits four segments of external factors, each with direct and indirect influences on the results of the activity of the corporate sector, respectively: *political factors*, *economic factors*, *social and cultural factors* and *technological factors*.

At the same time, considering the global impact of the COVID-19 pandemic, I consider appropriate to supplement the number of segments with the *Biological Factors Segment*. The fifth segment is currently a novelty factor for the economy not only of the Republic of Moldova, but also worldwide.

BIBLIOGRAPHY

1. Branko Novak and Domagoj Sajter. (2007). CAUSES OF BANKRUPTCY IN EUROPE AND CROATIA. Online at <https://mpra.ub.uni-muenchen.de/5833/>. MPRA Paper No. 5833, posted 20 November 2007 09:22 UTC
2. Dyrberg, A. (2004). Firms in Financial Distress: An Exploratory Analysis. Danmarks Nationalbank Working Papers, No. 17. Copenhagen: Danmarks Nationalbank.
3. Euler Hermes Kreditversicherung, Center for insolvency and reorganisation at the University of Mannheim (2006): Ursachen von Insolvenzen - Gründe für Unternehmensinsolvenzen aus der Sicht von Insolvenzverwaltern, http://www.zis.uni-mannheim.de/studien/dokumente/ursache_von_insolvenzen/414_wiko.pdf [Accessed 09.02.2019] [Accessed 09.02.2019]
4. Institute of Applied Humanitarian Research (2012 a), "Corruption in Private Sector" (Інститут прикладних гуманітарних досліджень, "Корупція в приватному секторі"), http://www.iahr.com.ua/files/works_docs/119.pdf
5. Lee, Tsun-Siou, Yin-Hua Yeh, and Rong-Tze Liu. (2003). Can Corporate Governance Variables Enhance the Predicting Power of Accounting-Based Financial Distress Prediction Models? Center for Economic Institutions Working Paper Series, No. 14; Kunitachi: Hitotsubashi University.
6. Muntean, N. Analiza stabilității financiare în sectorul corporative. (2019). Monography; Chișinău: Cartier, 152 p. ISBN 978-9975-86-407-7.
7. Ooghe H., Waeyaert N. (2004): Oorzaken van faling: literatuuroverzicht en conceptueel verklaringmodel, *Economisch en Sociaal Tijdschrift*, 57 (4): 367–393.
8. Ooghe, H., De Prijcker, S. (2006). Failure processes and causes of company bankruptcy: a typology, Department of Accountancy & Corporate Finance, Ghent University, Working Paper, No. 388, 2006.