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Duvnjak Valentina, University of Business Studies Banja Luka, Bosnia and Herzegovina,
valentina.duvnjak@univerzitetps.com

A REAL SHOCK (COVID-19 PANDEMIC) - IMPACT ON THE FINANCIAL CRISIS IN THE COMPANY AND THE ECONOMY AS A WHOLE

Summary: *This paper seeks to show the connection among several hypotheses from the scientific paper "Coping with Business Crisis in the EU Periphery: A Case of Bosnia and Herzegovina" and the crisis caused by an unexpected and unpredictable event COVID-19, which affected both enterprises and to the economy as a whole. This paper seeks to prove new hypotheses.*

The methods used during the research are: Hi square test (Pearson test), descriptive method, cabinet research, survey questionnaire and scenario method.

This paper attempts to answer why enterprises worldwide, after only a few weeks of "quarantine", face the problem of illiquidity, which has had a direct negative impact on macroeconomic aggregates. The purpose of the present study is to make a theoretical contribution and expand the existing fundamental knowledge in this area and show which financial restructuring measures can help to overcome the crisis in a stable environment and the environment that was disturbed by the sudden change as COVID-19 outbreak.

Key words: *company, crisis, COVID-19, financial restructuring, macroeconomic aggregates*

JEL classification: *E22, E24, G34, G35*

INTRODUCTION

This paper will present the results of the previous research on enterprises in crisis and the impact of the crisis in enterprises on the economy as a whole. The results of the research will be related to the crisis caused by the COVID-19 pandemic. Special attention will be paid to the analysis of the illiquidity of companies during the pandemic period. The paper will present the most common measures of financial restructuring of companies in order to overcome the crisis. After linking the previously set hypotheses with a real shock COVID-19 pandemic, we will try to confirm the following set hypotheses:

- Due to a sudden change, predicting business failure using cash flow information is irrelevant;
- Deferred payment or debt rescheduling is a measure of financial restructuring of a company whose effects depend on the environment in which the company operates.

1. REVIEW OF PREVIOUSLY SET HYPOTHESES

A company crisis is caused by numerous factors that can be internal and external. A company crisis that lasts for a long time has negative effects on the company regardless of the sector to which it belongs (Duvnjak 2018, 199). "Our Chi-square test (Pearson's test) confirmed the null

hypothesis that the duration of a crisis does not depend on whether the companies are production or service companies. Probability is higher than 0.05 and equals 0.548, showing that variables are not inter-connected" (Duvnjak 2018, 199). A crisis (Vladušić i Rebić i Hršum 2016) is never monocausal. The crisis creates a sequential response to all business segments. The crisis within the company has indirect consequences on other companies, but also on the entire national economy. Inadequate management of microeconomic instruments, poor management, failed acquisition, inefficient management of finances, marketing, production and inefficient organizational culture are not only problems within one company but create a negative multiplier effect on macroeconomic aggregates and the economy as a whole. On the other hand, the state as a regulator of the market and business conditions should create an environment so that companies can operate normally and successfully.

An earlier study based on the Chi-square test (Pearson's test) rejected the null hypothesis that the independent variables are the duration of the crisis in the company and how many and which parts are covered by the crisis (Duvnjak 2018, 200). "The probability is lower than 0.05 and equals 0.000, implying that variables are mutually connected. The Chi-square equalled 20.023. We rejected the null hypothesis and will include the interpretation with corrected standardized residuals, paying attention to them being higher than 2 in small tables, and higher than 3 in large tables (absolute values). Our tests showed that almost all were higher than 2. Percentage-wise, out of the total 56.52% of the companies that are entirely engulfed in crisis, 65.4% have been in crisis for a long time" (Duvnjak 2018, 200).

A company crisis must be recognized, namely the causes of the crisis, in order to timely respond, otherwise, there is a galloping spread of the crisis by all business segments, and negative effects on the economy as a whole. The size of the negative consequences at the macro level depends on the size of the company, impact on other related companies and the export orientation.

Most companies should have a crisis plan (Hough and Spillan 2005; Darling 1994; Rainer 1985), in order to prevent negative consequences both, at the company level and the entire national economy. "Our Chi-square test confirmed the null hypothesis that the existence of a crisis plan has no effect on the character of crisis if there is economic and political instability (Duvnjak 2018, 205). The probability is higher than 0.05, showing that the variables are not mutually connected" (Duvnjak 2018, 205).

Overcoming problems within the companies that are caused by external causes that the company could not influence depends on the economic development of the country. Businesses operating in a stable environment can plan for the long term.

"Our Chi-square test (Pearson's test) further confirmed the null hypothesis that restructuring measures need not depend on the recovery and development plans if the environment is unstable. The probability is higher than 0.05 as it equals 0.057, showing that variables are not mutually connected. However, since the difference is 0.007, it can be concluded that there is some connection, so the data should be analysed. This claim is based on the presumption that in an unstable environment, planning is often done on a day-to-day basis, and unplanned and sudden events may disrupt the planned activities of the company". (Duvnjak 2018, 205).

2. A REAL SHOCK (COVID- 19) FROM THE ASPECT OF PREVIOUSLY SET HYPOTHESES - IMPACT ON A CRISIS IN A COMPANY AND THE ECONOMY AS A WHOLE

An example of an external factor causing the crisis in companies is the COVID-19 pandemic, which can be seen as an unpredictable event that affected both the company's operations and the economy as a whole. An unexpected event affected a large number of companies, regardless of which sector of the economy they belong to. "Due to fear and uncertainty, and to rational assessment that firms' profits are likely to be lower due to the impact of COVID-19, global

stock markets erased about US\$6 trillion in wealth in one week from 24th to 28th of February. The S&P 500 index lost over \$5 trillion in value in the same week in the US while the S&P 500's largest 10 companies experienced a combined loss of over \$1.4 trillion, although some of these were recovered in the subsequent week'' (Ozili and Arun 2020, 2). ''The International Air Transportation Association (IATA) stated that the air travel industry would lose US\$ 113 billion if the COVID-19 outbreak was not quickly contained '' (Ozili and Arun 2020, 2). ''The IMF downgraded its growth projection for the global economy as the COVID-19 outbreak threw its earlier projection into serious doubt. The tourism industry was affected as the travel opportunities for Chinese tourists, who usually spend billions annually, were severely curtailed. There were increased flight cancellations, cancelled hotel bookings and cancelled local and international events worth over \$200billion. The flow of goods through global supply chains vastly reduced significantly given that China was the world's largest manufacturer and exporter, and the Chinese government ordered the closure of major factories in the country''(Ozili and Arun 2020, 2). Given that almost all sectors of the economy affected by the crisis (excluding pharmaceuticals), and in particular transport, industrial production and tourism have a multiplicative effect on other sectors of the economy and macroeconomic aggregates such as gross domestic product, gross national income, employment, investment, exports and import, the sudden event was reflected in the overall economic balance. Some companies have benefited (Alon 2020) and there has been a redistribution of profits, while the self-employed, small and medium enterprises have felt the biggest impact of the crisis caused by Covid-19. The crisis caused by COVID-19, depending on the duration, affects the company, spreads to all the segments of the business and the economy as a whole. Each government as the regulator of the market and business conditions with its measures may affect the mitigation and overcoming the crisis, particularly when it is caused by an external factor which is a sudden event. Since the balance of payments disruptions are not the result of structural and fundamental imbalances, as it is the case in countries where companies cannot find foreign markets, nor they can be competitive within the national economy but are the result of accidental or one-off imbalances, these disruptions can be mitigated by financing from monetary reserves.

After unexpected events, companies must react in time to avoid a deepening crisis within the company and galloping effects on the economy as a whole. Companies that have already had a contingency plan due to unexpected events (COVID-19) need to plan from day to day so that contingency plans can not affect the character of the crisis. Overcoming the problems within the companies that were caused by COVID-19, and which the companies could not influence, depends on the economic development of the country. Restructuring measures do not have to depend on the rehabilitation plan and development plan if the cause of the crisis is the COVID-19 pandemic which as an unexpected event can disrupt all activities of the company.

3. ANALYSIS OF COMPANY ILLIQUIDITY CAUSED BY COVID-19

The financial restructuring of the company should contribute to achieving an appropriate ratio of equity and borrowed capital, which would enable the company to apply a strategy of revitalization and achieve solvency (Duvnjak and Babić 2014, 91). The basic definition of financial restructuring focuses on achieving solvency. Based on the COVID-19 pandemic, it was realized that a large number of companies could not cope with the current, accelerated, optimal and current liquidity due to the unplanned event. Illiquidity is one of the financial indicators of business failure. Illiquidity is not the cause of the crisis but indicates the segment of business problems can occur. Many countries, depending on their economic development, have taken measures to alleviate the crisis in companies. However, the illiquidity of a large number of companies around the world in just a few weeks of the pandemic was a case study for the analysis of solving financial problems. Financial problems were solved in a way that the company's activities were focused on organizational restructuring, through a set of activities of the downsizing strategy (Cameron 1994) whose organizational action involves reducing the

number of employees in order to redesign the work processes leading to guidance to the efficiency and effectiveness of the company. This fact is confirmed by mass layoffs worldwide. However, the primary solution to the problem of illiquidity by laying off workers creates a negative multiplier effect on the decline in consumption, which is further reflected in the decline in macroeconomic aggregates (Mankiw 2000; Giovanni 2016; Ercolani and Azevedo 2018). The COVID-19 pandemic has shown that the illiquidity of companies in a short period of time can create serious social consequences. Measures of the state that regulates the market and business conditions can prevent negative consequences for the economy that have been arisen due to the reaction of many companies that used to have high profits, but due to current/sudden cash flow problems, through downsizing strategy reduced the number of employees in order to solve the illiquidity as a consequence of COVID-19. The question is whether these same companies, due to extra profits, proportionally reward and employ workers. The layoff is a result of modern economic theory and policy that labour costs are enormously increased and to dominate in the structure of production costs compromising efficiency. Thus, wage expenditures (Jovičić 2005) are always at a level that would not jeopardize profit and extra profit. Long-term lack of liquidity, leading to insolvency. Therefore, on the other hand, there are many companies, especially small enterprises and individual entrepreneurs whose survival after the COVID-19 pandemic is questionable and they can hardly return to normal business. Cash flow is the subject of planning in order to maintain liquidity and a cash flow plan control instrument. Cash flow is used as an instrument of financial analysis to measure yield strength in terms of profit replenishment and to analyze investment projects. During the existence of the company, it is expected that the profit and value of net assets will be equal to the net cash flow. Cash flow analysis is essential to differentiate companies with problems from vital companies. The effects of total cash flow and its components on the prediction of the accuracy of failure provide a better understanding of the relationship between liquidity and financial difficulties. Cash flow is useful information for assessing the solvency of a company, especially in conditions of great uncertainty. Short-term liquidity depends on the efficiency of cash management. Statements of cash receipts and disbursements are considered to be instruments of general purpose, which results directly from the opposition of income and expenses, which is done on an accrual rather than on a cash basis. Statement of cash flows is extremely useful for managing the short-term financial situation, and especially for assessing short-term liquidity and assessing solvency. On the one hand, there is a logical connection between cash flow and bankruptcy (Sharm 2001). On the other hand, due to unexpected events statements of cash flows to predict business failure are irrelevant because cash flow from ordinary activities is not measured properly, time series analyzes are not used, the importance of variables and cash flow components is not taken into account. Examining the relationship between cash flow components allows an understanding of its variability.

4. FINANCIAL RESTRUCTURING MEASURES TO OVERCOME THE CRISIS IN A STABLE ENVIRONMENT AND AN ENVIRONMENT DISTURBED BY AN UNEXPECTED EVENT COVID-19

In Bosnia and Herzegovina in 2019, 100 companies were sampled in order to determine the measures of financial restructuring. Activities envisaged within the financial restructuring include a number of activities (Figure 1).

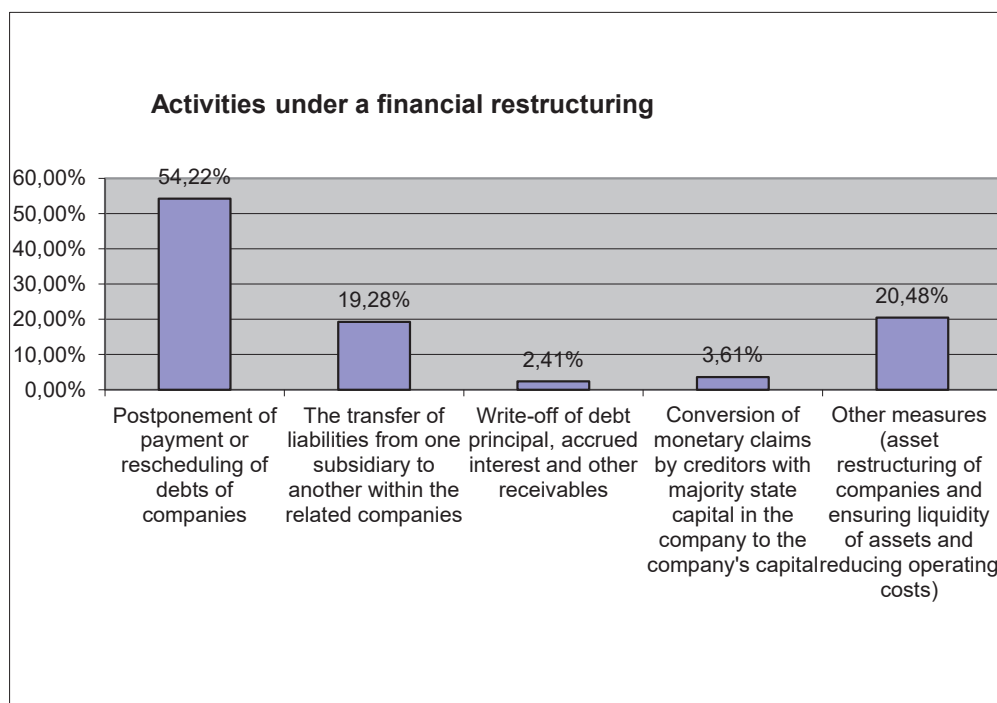


Figure 1. Activities under a financial restructuring (Author)

The research findings showed that the majority of surveyed managers (54.22%) consider financial restructuring to postpone payment or rescheduling of corporate debt, 19.28% of managers consider the transfer of liabilities from one subsidiary to another within related companies, 2.41% of managers consider write-off of debt principal, accrued interest or other receivables, 3.61% of managers consider the conversion of monetary claims by creditors with majority state capital into company capital and 20.48% of managers consider other measures. Other measures include recapitalization, pricing policy, filing lawsuits against defaulters, receivables collection measures in cooperation with the state, change in ownership structure, linking the collection of receivables with liabilities to the state and employees, financial injection, new loans from the Investment and Development Bank of the Republic of Srpska and the Development Bank of the Federation of B&H by a special decision of the Government, separation of companies into two separate companies.

Prediction of returning to normal operations can not be regarded in the same way for the companies which had been having a financial policy of excessive borrowing to solve the financial problems caused by irrational spending of funds and inadequate financial policy, then companies that have a problem of debt collection due to poor business environment and growing liabilities to the state and companies that fell into crisis due to unexpected event of COVID-19. The survey found that most of the managers surveyed considered deferred payment and debt rescheduling as a measure that would allow solvency to be established. If the company operates in a stable environment, to a legally institutional state that stimulates growth and development with its measures, the stated thinking of the manager is not correct. Inadequate policy to finance debt relief would have the result that the managers who did not do their job well would be rewarded instead of punished. This form of financial restructuring slows down the process of revitalization of the company, as it weakens the financial discipline of enterprises. If a company operates in an environment where there is inadequate cooperation between the state administration and an unreliable legal and institutional framework, there is a decline in

economic activity and a loss of the market. In such circumstances, although the market is limited, there is an increase in liabilities to the state. Due to the poor business environment, companies have a problem collecting receivables. All this implies that companies are over-indebted. In such circumstances, in order to establish liquidity and then solvency, the only transitional solution is to defer payment or reschedule debts. Research has shown that the minimum number of managers is considered to be the write off of debt principal, interest and other receivables, which is further evidence that companies do not prefer to shift the burden of bad business to the state or some other interest groups. Companies prefer to establish a legal and institutional framework that will enact easier business regulations and protect businesses. However, it is considered that the number of companies that have a realistic chance of establishing their solvency through debt rescheduling is much smaller than the expectations expressed by managers. Given the financial situation of the majority of the surveyed companies, the question is whether this measure can contribute to the revitalization of companies.

Other measures such as reducing costs and generating revenue from the sale of parts of the company should enable the repayment of parts of the debts. The transfer of liabilities from one subsidiary to another aims to motivate potential investors to buy part of the company. Substitute debt for an equity stake in the company is made only by creditors with majority state capital and by the state to collect budgetary obligations of companies. This measure is formulated considering that most of the debts of the social enterprises refer to debts to the state and by substituting debt for a share of these companies in the equity, the state becomes the owner of a portion of the capital of these companies before the privatization process.

Deferred payments or debt rescheduling is a financial restructuring measure that in the case of COVID-19 is the most adequate in order to overcome the problems and prevent a deepening crisis. Deferring payments or rescheduling debts is an opportunity for companies that have the potential to generate income in a shorter period of time or achieve revenue in the near future which will service the debt. If we consider that the problems arose due to a sudden event where the world "stopped" as well as the activity of companies, and not because of the inability to cope with competitiveness because the market existed before the COVID-19 pandemic, such companies by delaying payments and rescheduling debt can return to normal operations. Due to the COVID-19 pandemic, this measure was joined not only by companies in BiH, but also by companies in most countries of the world. The return of enterprises to normal operations has a positive effect on the economy as a whole, so the policies of the nation-state must be in positive interaction with enterprises in order for macroeconomic aggregates to grow.

CONCLUSION

The COVID-19 pandemic has affected a large number of companies, regardless of the sector. The crisis caused by COVID-19, depending on the duration, affects the company, its business segments and the economy as a whole. Due to the unexpected events (COVID-19) a crisis plan cannot affect the character of the crisis. During this period the company must plan from day to day. Restructuring measures do not have to depend on a business recovery plan and development plan if the cause of the crisis is the COVID-19 pandemic, as a sudden event can disrupt all activities of the company.

Given that problems in companies have arisen as a result of an unexpected event because the world has "stopped", cash flow statements to predict business failure are irrelevant. Deferred payments or debt rescheduling is the measure of the financial restructuring of companies that managers apply the most. However, whether this is an adequate measure depends on the environment in which the company operates.

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