The Risk Management of Companies from Timis County Involved in International Business

GABRIEL BÎZOI
ALEXANDRA POPESCU
Faculty of Economics and Business Administration
West University of Timisoara
16 Pestalozzi Street, 300115, Timisoara, Timis
ROMANIA
gabi.bizoi@gmail.com, alexandra.popescu@feaa.uvt.ro
http://www.gabi.bizoi.home.ro

Abstract:
Rapid internationalization of economic activities following the Second World War has generated an unprecedented increase in international trade and capital flows. For example, only during 1963 - 1993, exports rose from 157 billion to 3.774 billion dollars. Also the flows of foreign direct investment (FDI) have grown exponentially. Although FDI flows are concentrated to developing countries, 80% being targeted towards 10 countries, capital flows towards the Third World have quadrupled only between 1990 and 1993. This trend towards a truly international economy influences also on how companies do business. International business environment provides many opportunities, as well as threats. Romanian companies need to align to this trend. In addition to identifying new opportunities to do business on foreign markets, they have to deal with specific risks, which they did not have to face when working internally. In this context, we consider necessary to launch an investigation, whose main objective would be to analyze the manner in which Romanian companies manage risks specific to international economic affairs. As the complexity of these businesses is great, and the majority of Romanian companies, in their attempt to internationalize, use classical forms of export - import, the analysis took into account only the export activity undertaken by Romanian companies. We mention that we did not take into account the determination of the exposure to these risks of the companies concerned, but an analysis of the management of those risks. For this analysis, data were collected based on the administration of a questionnaire, and these data were used to develop an econometric model analysis. The specific methods of risk analysis of specific export transactions are then interpreted using the GLOBE model.

Key-Words: risk management, risk exposure, probability, commercial risks, currency risk, GLOBE model

1 Introduction

In order to analyze how the management of export operations’ specific risks, we have considered the commercial risks which may arise from carrying out such operations and the foreign currency risk faced by any exporter. The manner in which these risks are being managed has been put in line with the turnover and more specifically, the turnover from exports. But as the calculation methodology for the two indicators is quite different (turnover is calculated on the basis of added value, being found in the profit and loss account, exports turnover is reported to the total value of exports. For the outsourcing operations, for which the raw material and some materials are being imported, reporting exports is not made only taking into account just the exported labor, but the entire value of the exported product. In this manner there may occur situations where the exports turnover, reported through a different methodology from that used in the calculation of total turnover, is greater than the total turnover - where the share of processing in outsourcing operations is high). To eliminate this shortcoming, we have used the normalization of the total turnover, and of the exports turnover.

In order to collect the necessary data for the analysis of the management of specific risk for the export operations a questionnaire was administered, having no availability of such data. The questionnaire aimed to collect data from all firms in the Timis County performing export operations, summing 83 companies (the research, therefore, was based on census and not on sampling). The period of analysis covers a period of three years, 2006-2008. Since there were two companies, which had no financial reports for two years, in order not to distort the results of analysis model, these were not taken into account, panel data being then limited to 81 companies. Questionnaire administration took place from May to September 2009.
2 Problem Formulation

Poor risk management can have different causes: lack of appropriate training for company managers, organizational culture of that company or specific societal culture for western Romania. It is important to determine how specific risks of export operations are being managed and the causes leading to such management.

2.1 Data collection

Investigated firms are from different fields of activity, as can be seen from Table 1. Most companies are companies that have as their main activity production (68.84%); following, are commerce companies (7 - 8.64%) and then transport and telecommunications companies (3 - 3.70%).

In order to manage commercial risks, the first important step is the assessment made by the exporter of the default risk. In this respect, some mechanisms to mitigate or even eliminate the negative effects of default risk – the risk to be unpaid – (total or partial) need to be retained:

- Exporter’s conduct of an analysis of the bankruptcy risk of the importer in order to determine its creditworthiness; as can be seen from Table 2, only about 17% of the firms engaged in Timis county’s export operations analyze the creditworthiness of their external partner;
- Highlighting the used method of payment (payment order, documentary collection, documentary letter of credit), knowing that these methods involves different default risks of the importer, if it is of bad faith Table 3 shows that the vast majority of the examined firms (approximately 82%) use the payment order as method of payment, hence their vulnerability to the default risk due primarily to the importer’s bad faith;
- Drawing a bill of exchange on the importer: to reduce the default risk due to importer’s bad faith, the exporter can draw a bill of exchange;
- Exporter’s request for a letter of credit in its favor;
- Mention in the contract the method of determining the quality and quantity of goods and the place of making such determinations, so as not to arrive to the situation where the importer can report quantitative or qualitative deficiencies of goods when not paying the full value of the imported goods. If we analyze the data presented in Table 4, we note that almost all analyzed companies (over 96%) use in international concluded sale contracts a method to determine the quality of goods, but if we correlate this information with those in Table 5, we note that a small proportion of these companies do not mention in the contract the place of determining the quantity of goods, thus offering the importer the possibility, if it is of bad faith, to report some qualitative loss in order to avoid full payment of the imported products.

Table no. 1

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Abs. frequency</td>
<td>68</td>
<td>7</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Rel. frequency</td>
<td>83.95%</td>
<td>8.64%</td>
<td>1.23%</td>
<td>3.70%</td>
<td>1.23%</td>
<td>1.23%</td>
</tr>
</tbody>
</table>

Table no. 2

<table>
<thead>
<tr>
<th>Importer’s bankruptcy risk analysis</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abs. frequencies</td>
<td>14</td>
<td>67</td>
</tr>
<tr>
<td>Rel. frequencies</td>
<td>17.28%</td>
<td>82.72%</td>
</tr>
</tbody>
</table>

Table no. 3

<table>
<thead>
<tr>
<th>Used method of payment</th>
<th>Payment order</th>
<th>Documentary collection</th>
<th>Documentary letter of credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abs. frequencies</td>
<td>74</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Rel. frequencies</td>
<td>91.36%</td>
<td>2.47%</td>
<td>6.17%</td>
</tr>
</tbody>
</table>

Table no. 4

<table>
<thead>
<tr>
<th>Mention in the international purchase agreement</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abs. frequencies</td>
<td>78</td>
<td>3</td>
</tr>
<tr>
<td>Rel. frequencies</td>
<td>96.30%</td>
<td>3.70%</td>
</tr>
</tbody>
</table>

Table no. 5

<table>
<thead>
<tr>
<th>Mention in the international purchase agreement</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abs. frequencies</td>
<td>74</td>
<td>6</td>
</tr>
<tr>
<td>Rel. frequencies</td>
<td>91.36%</td>
<td>7.41%</td>
</tr>
</tbody>
</table>

Price risk is another risk to which companies running commercial contracts are exposed, particularly those that carry international trade agreements. In most international sale contracts concluded by the examined firms (84%) there is not provided any protection clause to the negative effects of price risk. For firms using such clauses, the most common is the price revision clause (approximately 10% of cases).
To provide some explanations for such managers’ behavior from the surveyed firms we consider necessary to present some of the GLOBE research results from Romania, research to which we have taken part. GLOBE research conducted in Romania aims to identify the characteristics of organizational culture, values and practices in organizations in Romania. The project was realized through the participation of 48 academics from 12 universities from Romania. Characteristics of the organizational culture were highlighted by nine dimensions:
- distance to power
- uncertainty avoidance
- institutional collectivism
- group collectivism
- gender equality
- assertiveness
- human orientation
- orientation towards performance
- Orientation to the future.

3 Problem Solution
In order to solve that problem, we will present each dimension, insisting on three dimensions we consider being relevant from the perspective of the initiated scientific approach: uncertainty avoidance, performance orientation, future orientation. In that way, we will identify from the angle of those three dimensions the causes that determined the adoption or non-adoption, of some specific methods of the management of the risks specific to export operations.

1. Power Distance
Power Distance that represents the degree to which members of an organization or society expect and agree that power should be stratified and concentrated at higher levels of an organization or government.1 The results for that dimension in the Romania case compared with the 62 Globe countries are presented in the table no. 8.

Table no. 8

<table>
<thead>
<tr>
<th>Power Distance</th>
<th>GLOBE 62 countries</th>
<th>Romania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>4.01</td>
<td>3.66</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>0.67</td>
<td>1.29</td>
</tr>
<tr>
<td>Mean</td>
<td>3.56</td>
<td>3.73</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>0.44</td>
<td>0.91</td>
</tr>
</tbody>
</table>


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To next, we aim to capture how firms manage currency risk analysis. Information about the used risk management procedures are summarized in Table. 7. It is noted that most analyzed firms (89%) are not using any method of currency risk hedging. Of those using a method of hedging against the negative effects of this risk, the most common procedure is the use of forward contracts at a particular bank on the contract’s currency (about 10% of the analyzed firms). Note that none of the examined companies do not use put or call options to mitigate the negative effects of currency risk.

Table no. 7

<table>
<thead>
<tr>
<th>Currency risk management methods used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Method</td>
</tr>
<tr>
<td>No method</td>
</tr>
<tr>
<td>Use of future contracts</td>
</tr>
<tr>
<td>Use of forward contracts at SIBEX</td>
</tr>
<tr>
<td>Use of call or put options at SIBEX</td>
</tr>
</tbody>
</table>

Abs. frequenci es 72 0 1 8 0 0
Rel. frequenci es 88,89% 0,00% 1,23% 9,88% 0,00% 0,00%

To the analyzed firms involved in export operations there can be observed a weak management of commercial risks (Table no. 2 Table. 3 Table. 4 Table. 5 and Table. 6) and of the currency risk (Table no. 7). We will try to identify the causes of such poor management of the main risks specific to export transactions.

2.2 Interpretation of the risk specific to export activities with the GLOBE model
In the analysis of the 81 companies we have noticed that the methods to mitigate the adverse effects of market risk and currency risk are underused. One explanation, at least in terms of business risk management may be that the export transactions are conducted with traditional partners, and increased confidence.

But the lack of skills to mitigate the negative effects of export operations’ specific risks lead to the conduct of content by having only traditional partners and so new attempts to find foreign partners were low.
We can observe that the power distance in Romania is higher than mean of the rest of the countries, if we refer to practices. If we refer to the values, the Romanian managers wish as that distance to be higher, to grow, as while the mean of the other countries indicates a desire of reduction that power distance.

2. Uncertainty Avoidance

Any member of an organization or society strives to avoid uncertainty by relying on established social norms, rituals, and bureaucratic practices\(^2\). The results for that dimension are as they follow (higher scores indicate greater uncertainty avoidance; lower scores indicate uncertainty bearing):

- **Societal practice (as is):**
  - Mean of the 62 GLOBE countries: 4,16
  - Maximum score: 5,37 (Switzerland); 5,32 (Sweden); 5,31 (Singapore)
  - Minimum score: 3,30 (Guatemala); 3,12 (Hungary); 2,88 (Russia)
  - Standard deviation: 0,60

- **Societal values (should be):**
  - Mean of the 62 GLOBE countries: 4,62
  - Maximum score: 5,61 (Thailand); 5,60 (Nigeria); 5,37 (Albania)
  - Minimum score: 3,32 (Germany); 3,24 (Netherlands); 3,16 (Switzerland)
  - Standard deviation: 0,61

- **Romanian societal practice (as is):**
  - Mean: 3,66
  - Standard deviation: 0,96

- **Romanian societal values (should be):**
  - Mean: 5,39
  - Standard deviation: 0,84

Taking into consideration those presented aspects, the Romanian situation is as it follows:
- 17th lowest (46th from the top) uncertainty avoiding societal practice among the 62 GLOBE societies, and would belong to band (C) group of countries (Relatively low Uncertainty avoidance group - e.g. uncertainty bearing)
- the 3rd highest uncertainty avoiding societal value among the 62 GLOBE societies, and would belong to band (A) group of countries (High expected Uncertainty avoiding group).

In conclusion, the Romanian managers feel (perceive) relatively high uncertainty in their society and they would like to belong to a society providing much more certainty, and live and work within a more predictable environment. The results obtained for Romania: high uncertainty avoidance and the need for a very stable environment could be explained by the following reasons:

- One of the most surprising findings of the GLOBE societal cultural results in Eastern Europe is the high uncertainty bearing. All the religious traditions in the region suggest uncertainty avoidance;
- Romanian society is traditional and by the 45 years of communism that have emphasized a highly stable, rigid, highly projective social environment. The rate of change was controlled, work and life were controlled, while being quite predictable if you were respecting social rules and norms;
- After 1989, "a collective cultural shock" happened: people, accustomed with stability, rigidity, all of a sudden have been confronted with a very high intensity of social, political, economical, legal, cultural change. That led people being unable to cope with the magnitude of change, well beyond their capability to assimilate change. Consequently, their adaptability has been surpassed and their need for stability and uncertainty avoidance remained high.

3. Institutional Collectivism

Institutional Collectivism (Collectivism I) is the degree to which organizational and societal institutional practices encourage and reward collective distribution of resources and collective action. This variable (as a construct) is identical with the Individualism-Collectivism scales used in the culture literature (for example by Hofstede).

4. In-Group Collectivism

In-Group Collectivism (Collectivism II) is the degree to which individuals express pride, loyalty, and cohesiveness in their organizations or families.

5. Gender Egalitarianism

Gender Egalitarianism is the degree to which an organization or a society minimizes gender role differences while promoting gender equality.

6. Assertiveness

Assertiveness is the degree to which individuals in organizations or society are assertive, confrontational, and aggressive in social relationships.

7. Humane Orientation

Humane Orientation is the degree to which individuals in organizations or society encourage and re-wards individuals for being fair, altruistic, friendly, generous, caring, and kind to others.

\(^2\) ibidem
8. Performance Orientation

Performance Orientation is the degree to which an organization or society encourages and rewards group members for performance improvement and excellence. The statistics regarding the performance orientation is (a higher score indicates greater performance orientation):

- Societal practice (as is):
  - Mean of the 62 GLOBE countries: 4,10
  - Maximum score: 4,94 (Switzerland); 4,90 (Singapore); 4,80 (Hong Kong)
  - Minimum scores: 3,39 (Russia); 3,32 (Venezuela); 3,20 (Greece)
  - Standard deviation: 0,41

- Societal values (should be):
  - Mean of the 62 GLOBE countries: 5,94
  - Maximum score: 6,58 (El Salvador); 6,45 (Columbia)
  - Minimum scores: 5,25 (South Korea); 5,17 (Japan); 4,92 (South Africa)
  - Standard deviation: 0,34

- Romanian societal practice (as is):
  - Mean: 3,51
  - Standard deviation: 1,07

- Romanian societal values (should be):
  - Mean: 4,92
  - Standard deviation: 0,60

Taking into consideration what is presented above, Romanian situation is as follows:

- Romania ranks as the 6th least Performance oriented societal practices among the 62 GLOBE societies;
- Romania ranks the 2nd least Performance oriented societal value among the 62 GLOBE societies, and would belong to band (E) group of countries (Lowest expected Performance orientation group). Romanian practice score is one of the lowest in the world (sixth from bottom). The "should be" score is much higher, but still this score is much lower than world average.

We appreciate that Romanian managers do not seem to perceive a social environment that encourages and rewards performance, but although expecting substantial improvement in Performance orientation, this strive for being more performance oriented is still lagging well behind other countries improvement expectations. Social environment is not encouraging and is not rewarding individual, nor group performance. On the contrary, the widely accepted belief is still that if you are a rich person, you are not fair, not honest, and not a good person. We consider that reasons for that is first, the orthodox faith that preaches and emphasizes modesty, humility, and acceptance of one’s situation and then the former communist ideology based on collective property, egalitarianism and interdiction of accumulating wealth, leading to the vilification of rich people and destructive envy towards those being better well off. On the other hand, there is a belief that one doesn't get a proper and equitable reward according to his or her efforts and dedication. This belief is maintained also by the motivational system that doesn't reward sustainable performance. Doing things right is an obligation, therefore is normal, so there is no need for a reward. So, there is no incentive for doing them better. The Romanian societal culture has not yet a “cult for performance”, other characteristic being the treating problems superficially.

9. Future Orientation

Future Orientation is the degree to which individuals in organizations or societies engage in future oriented behaviors such as planning, investing in the future, and delaying individual or collective gratification. Statistics regarding the future orientation is (higher scores indicate greater future orientation):

- Societal practice (as is):
  - Mean of the 62 GLOBE countries: 3,85
  - Maximum score: 5,07 (Singapore); 4,73 (Switzerland); 4,64 (South Africa)
  - Minimum score: 3,11 (Poland); 3,08 (Argentina); 2,88 (Russia)
  - Standard deviation: 0,46

- Societal values (should be):
  - Mean of the 62 GLOBE countries: 5,48
  - Maximum score: 6,20 (Thailand); 6,12 (Namibia); 6,07 (Zimbabwe)
  - Minimum score: 4,79 (Switzerland); 4,73 (China); 4,33 (Denmark)
  - Standard deviation: 0,41

- Romanian societal practice (as is):
  - Mean: 3,33
  - Standard deviation: 0,96

- Romanian societal values (should be):
  - Mean: 5,56
  - Standard deviation: 0,89

Taking into consideration what is presented above, Romanian situation is as follows:

- Romania ranks as the 10th least Future oriented societal practice among the 62 GLOBE societies, and would belong to band (C) group of countries (Relatively low Future orientation group)
- the 32nd in Performance oriented societal value (in the middle) among the 62 GLOBE societies, and would belong to band (B) group of countries (Relatively high expected Performance orientation group)

4 Conclusion

In conclusion, we appreciate that Romanian managers consider that it pays to focus on the present situation rather than on future planning, improvement orientation is however expected in the future (exhausted). Orientation is primarily directed to daily problems,
perceived as urgent and complex. Today is much safer than the future. The uncertainty of the future is very difficult tolerated in Romania. Therefore, the managers of the 81 firms in the Timis county studied which conduct export operations prefer traditional partners, because they involve business relations with less risk. But such an approach prevents exploitation of opportunities, exploitation which would involve more risks to manage.

To improve these aspects, we suggest that the research results on methods of risk management, orientation towards the future and towards performance, compared to other companies’ situation from Western Europe, be made known to Romanian managers. Meanwhile, we consider useful that the managers attend training courses for risk management, leading to a different approach on their behalf on the methodology of risk management. Another proposal would be to consider mandatory a risk management system, something that could be done by the audit activity (external), similarly to what happens in the U.S. by the Sarbanes-Oxley Act, or in Europe (German Commercial Code). However, we consider that a risk management system (including risks specific to foreign trade operations) would be better implemented if it is implemented by managers because of their beliefs, not because of a legal requirement.

References:

3 For many American companies risk management is seen as a legal requirement following the introduction in the United States of the Sarbanes-Oxley law. Also in Europe there was a legal provision for a formal risk management system. For example, the German Commercial Code provides a preliminary recognition system to identify risks that threaten the existence of a firm in its start up period.