Economic Insights – Trends and Challenges	Vol.IV(LXVII) No. 4/2015	53 - 62

Financial Stability in the Microeconomic Field – Theoretical Aspects and Proposals

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Abstract

The field of financial stability, in general, is something new for the international research – field of activity which is both related, as shown by the existing researches, and motivated as research interest – by the different aspects of the financial instability, as they have been and still are perceived, these years, at the international economic level. Consequently, the microeconomic financial instability, evaluated in terms of the aspects related to stability, is a consequence of both external factors related to the market on which the company operates, and internal factors related to the company management – each of these factors, if they degrade compared to the initial state of the company objectives, having the capacity to induce shocks in the activity of the company – shocks received and transformed in various aspects of the degrading financial stability.

Keywords: *microeconomic; financial; stability; instability; performance*

JEL Classification: *D 50*

Introduction

The main objectives of the present paper are:

- proposal of a concept of financial stability and of the associated conceptual derivatives according to the specific activity and interest of the microeconomic domain;
- proposal of coordinates for the introduction, within the microeconomic managerial culture, of the importance of the objective of securing the financial stability;
- identify the main managerial ways (methods, techniques, instruments) of ensuring the state of financial stability;
- evaluate the impact of the potential changes within the business environment on the financial stability of the company.

The secondary objective of the paper is to make the proposal a financial stability concept and of the associated conceptual derivatives according to the specific activity and interest of the microeconomic domain.

Aspects regarding the Investigated Domain

In terms of the approach, the mentioned research interest was directed mainly towards the macroeconomic level, probably because both the effects and the responsibility of managing the associated risks have macroeconomic origin.

From the microeconomic point of view, the research on financial instability analysed mainly the strictly local aspect of this matter, such as the financial balance of a company in terms of the associated indicators.

Both at the macroeconomic and microeconomic level, the novelty of the research on financial instability, proved, first of all by the current situation of the economic events occurring on the international markets, is mainly associated to the aspect of present economic phenomena and processes, whose theoretical analytical facts (generating sources, forms of manifestation and evolution, factors of influence, indicators of evaluation) are yet to be fully ascertained.

Research Directions

Taking into consideration these facts, we will start our analysis from the following facts:

- the financial stability at the microeconomic level cannot be reduced to the study of the financial balance or of the financial state of the company, since the company activity includes movable items on the balance, which are related to or influenced by the financial fluctuations of the market, which requires a dynamic vision, associated to the market, of the financial stability of the company;
- such approach is not intended to contest or complete the existing studies and analyses in the field of financial balance or financial state of a company, because the proposed concept of financial stability also intends to introduce another dimension of the evaluation of the microeconomic activity;
- both as research direction, and as reason of selecting the research domain, the theoretical-methodological approach of the economic category of financial stability of the company aims to prove the need to introduce this dimension of evaluation of the financial activity of the company, which to complete the analytical procedures already in use with aspects related to the status of the company in terms of participant in economic relations undergoing continuous evolution – aspects that are both necessarily to approach and representative for the way in which the activity of the company is involved in the market;
- the dynamic aspect of considering the activity of the company as participant to the evolution of the economic relations within the market – defining the evaluation of the financial stability of the company according to this approach – induces the characteristic of *transience* associated to this evaluation, which shows a much briefer validity compared to the already known categories of financial balance and financial status of the company;
- however, the importance of studying this approach on the evaluation of a company is necessary both because it reflects the integration of the company activity within the economic activities of a market submitted to rather similar risks of financial instability, and because it is necessary to approach the economic category of risk at the methodological level of completing the board of indicators whose quantification completes the input data needed to make a decision at the microeconomic level;
- for the development of the concept of financial stability of the company it is necessary to start from the concept of financial stability (analysed in general and associated to the macroeconomic approach), because, at this moment it looks like the risks of macroeconomic financial instability reverberate, in a decisive manner, on the

microeconomic activity too, the size of the influence being directly proportional to the size of company's involvement within the economic relations on the market;

- within this analysis we decided, in developing a concept of microeconomic financial stability, to start from ideas and concepts of the investigated area associated to the macroeconomic approach, because:
  - the problem of financial instability, without trying to determine the macroeconomic or microeconomic source of the phenomena and of the processes that are susceptible to generate financial instability, has been first noticed and analysed within a dimension close to the reality, at the macroeconomic level, both in order to understand the phenomena and processes, and to identify the administrative solutions;
  - the macroeconomic financial instability also generates microeconomic financial instability – as it will be proved within this analysis; the reciprocal is not true, at least until the concurrence of a scale dimension of the phenomena of microeconomic financial instability on the market.
- consequently, our analysis will start from a general concept of financial stability that will be completed by aspects regarding the microeconomic level of approach.

Theoretical Facts

At the current theoretical level, due to the progressing evolutions of the phenomena and processes that generate risks of financial instability within the various segments and areas of the international market, and because these processes and phenomena are insufficiently known, since they are currently in progress, there is not yet a unanimously accepted definition of the category of financial stability.

Various definitions of the concept of financial stability have been developed at the academic or macroeconomic administrative levels, starting probably from observed hypotheses or scenarios; among them, using the criterion of the experience which their authors have in the matter of studies and researches in the field of macroeconomic policies, and also considering the criterion of the representativeness of the institutions involved in the analysis of these problems, we consider that the following ones are relevant:

- Thus, F. S. Mishkin, in his paper "Global Financial Instability: Framework, Events, Issues," published in the *Journal of Economic Perspectives*, vol. 13(4), 1999:
  - Considers that one of the main elements if the macroeconomic administrative capacity is the ability to ensure the efficient functioning and performance of the real economic system, even in the presence of economic shocks
  - Regarding the subject matter, the macroeconomic financial stability, the state of instability appears due to the interference of macroeconomic financial shocks with the normal flow of the economic activity, which prevents the continuity of the financial system trend towards channelling the funds in the direction of productive opportunities;
- In the same sphere of the macroeconomic administrative capacity, G. J. Schinasi, in his paper "Safeguarding Financial Stability: Theory and Practice", published under the aegis of the International Monetary Fund, in 2006, considers that a (macroeconomic) financial system is in a state of stability when it is able to facilitate the economic performance (at the level of the real economy) and to apply administrative solutions in controlling the risks of financial imbalance that may occur as results of adverse phenomena;

- The National Bank of Romania (presentation from 2011, at Dolj branch of BNR) defined the concept of financial stability as follows: the concept of financial stability doesn't yet have an established definition, nor is it a standardized pattern or analytical framework of evaluation; the financial stability is noticeable in the situations in which there is no systemic crisis; at the same time, we may say that a financial system is stable when it is able to allocate efficiently its economic resources (spatially or temporally), to evaluate and manage adequately the financial risks and to self-correct when it is affected by exogenous shocks; in other words, the financial system is stable when it becomes able to exert its function of intermediation, thus facilitating the performance of an economy and to absorb the shocks by correcting some imbalances that occurred due to adverse evolutions;
- The European Central Bank defines the financial stability as follows: the financial stability can be defined as a condition in which the financial system – established from financial intermediaries, markets and market infrastructures – is able to manage the shocks so as to reduce the adverse shocks received by the processes of financial intermediation – effects which are sufficiently significant as to influence the allocation of funds towards profitable investment opportunities; the three parts of the financial system are:
  - Financial intermediaries, such as the banks, the insurance companies and other institutional investors which direct the funds from savings towards investments;
  - Financial markets, where the offer and demand for funds meet, such as monetary markets, stock exchange units;
  - Financial market infrastructure, by which the funds and financial assets circulate between the offer and demand, such as the payment systems, the systems regulating the movable values;

With these clarifications, the financial system can be regarded as stable, if characterized by the following:

  - The financial system must have the capacity to transfer rapidly and efficiently resources from savings towards investments;
  - The financial risks must be quantified and evaluated with reasonable accuracy and must be properly managed;
  - The financial system must be in such condition, as to be able to absorb comfortably the real financial and economic shocks.

The European Central Bank concluded that if one or any combination of the above-mentioned conditions cannot be maintained, the financial system tends to become less stable – state that can be perceived as instability.

- Cass Business School in London defines the financial stability as the property of the macroeconomic administrative system that has the following significance: a stable economy is the one characterized by the fact that it doesn't pass degeneratively through a state of instability that comes from the receipt of disturbances; within the economic context, a disturbance can be represented by received and transmitted shocks; a characteristic of the system's stability is the dampening and absorption of shocks until no significant disturbances occur within the evolution of the market economic processes;
- The Bank of International Settlements also proposed a set of indicators to evaluate the state of financial stability – indicators which, for the environment of the real economy, corresponding to the microeconomic area, are as follows:
  - Debts/ Total assets, which measures the level of indebtedness of the company, and whose interpretation says that a very high level of this indicator may induce a state of difficulty to reimburse the debts;

  - Revenues/ Operational expenditures, which measures the ability of the company to make payments from internal resources, and whose interpretation says that a too low level of liquidities may be a sign showing the incapacity of the company to make payments;
  - Exposure to the currency risk/ total assets, which measures the currency risk associated to the transactions of that company, and whose interpretation says that a too high level of this indicator may be a sign showing the financial difficulties of the company generated by the currency risk;
  - Financial losses, which measures the difference between the level of the expected financial revenues and the actual level of the revenues, and whose interpretation says that a high level of this indicator may show a level of insolvency which, in turn, generates operational risks.

Following are *several conclusions* resulting from the theoretical approaches of the concept of financial stability of the macroeconomic financial system:

- The financial stability is part of the economic stability;
- The financial stability is a characteristic of system manageability;
- The financial stability relies on the fulfilment of conditions of proper functionality of the subsystems composing the macroeconomic financial system – generically represented by the following desiderata:
  - Optimally developed institutional infrastructure, so that its functioning constitutes the practical, methodological representation of the processes required for the achievement of the functionality objectives of the system;
  - Institutional and methodological complexity of the administrative capacity correlated to the evolutive possibilities of the economic market;
  - The economic-financial state of the managed system must allow:
    - optimal progress of the real processes that define the evolution of the system according to its objectives;
    - administrative intervention with the purpose to:
      - optimise the progress of processes;
      - manage the risk-generating events;
      - manage the events resulting from risks.

That is, the concept of financial stability of the macroeconomic systems concerns the following aspects:

- The characteristic of system manageability, resulting from the economic-financial state;
- The capacity of system manageability correlated with the complexity of the managed system – biunivocal relation consisting of:
  - The institutional infrastructure – ensuring a minimal complexity of the managed system, so as to be able to apply the necessary administrative policies;
  - The methodologic infrastructure – ensuring a minimal methodological framework necessary for the implementation of the administrative policies.

Within the context of transferring the matter to the microeconomic level, one has to set new directions of analysis in order to identify the main aspects that define the future concept of financial stability.

Proposals

Some aspects that have to be approached within the context of evaluating the level of microeconomic financial stability are as follows:

- The financial stability of the company must be seen within the context of its involvement within the economic relations on the market; thus, the following aspects must also be approached:
  - Relation between the *financial stability* and the *financial balance*;
  - Relation between the *financial stability* and the *quality of assets*;
- The financial stability of the company is not synonymous with the economic performance of the company, because there can be financial stability even if there is low, declining microeconomic performance; however, the microeconomic financial stability cannot exist under conditions of drastic decrease of the microeconomic performance, reason why we also have to approach the relation between the *financial stability* and the *economic performance*;
- The financial stability of the company is influenced by the macroeconomic financial stability through the assets of the company, via the mechanism of receiving market shocks – aspects which also associates the relation with the quality of company management; thus, we can have the following variants:
  - Macroeconomic financial stability – microeconomic financial stability;
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  - Macroeconomic financial instability – microeconomic financial instability;
- Regarding the possible variants mentioned above, we also have to determine the segment of market pertaining to the evaluation of the level of microeconomic financial stability, which give us the following variants:
  - General microeconomic financial stability;
  - General microeconomic financial instability
  - Microeconomic financial instability on a segment of the market;
  - Microeconomic financial instability for isolated cases.

Conclusions

- The microeconomic financial instability is related to:
  - macroeconomic financial stability– influence – determination;
    - quality of the assets;
    - general conditions of the market;
  - quality of the microeconomic management;
    - quality of the assets;
    - financial management;
  - microeconomic financial stability of the business partners;

- the microeconomic financial stability is influenced by:
    - the level of company liquidity;
    - the level of financial losses.

The external factors that might influence the state of the financial stability of the company are determined by the state of the microeconomic financial stability, their relation with the financial stability of the company being:

- quality of assets – which influences the state of financial stability of the company through the financial evolution of these assets, knowing that one of the basic pillars of the business activity is to make financial assets;
- level of the demand – which influences the state of financial stability of the company through the influence of the macroeconomic financial stability on the external purchasing power of the company, the purchasing power that determines the demand;
- level of the costs – which influences the state of financial stability of the company through the influence of the macroeconomic financial stability on the internal purchasing power of the company, the purchasing power required by the company so that it can meet the requirement of commercial inputs;
    - level of the prices – which influences the state of financial stability of the company;

Conceptual elements of the financial stability of the company

- the financial stability of the company is evaluated in relation with:
    - internal conditions;
    - external conditions – the market;
- since the term of financial stability refers to a state, we propose to approach the concept of financial stability under the dynamic conditions of company's activities, making an evaluation of the state of financial stability under conditions of performance, point of view from which we will study the relation between the *financial stability* and the *economic performance*.

Relation between concept and evaluation

The concept of microeconomic financial stability presumes:

- development of a set of indicators and of a methodology of evaluation of the level of financial stability;
- development of a set of administrative principles for the accomplishment and maintenance of the state of financial stability.

Thus, compared to the macroeconomic approach, we propose the following configuration of the main aspects converging towards the development of the concept of microeconomic financial stability:

- conditions;
- necessary aspects for the accomplishment of the conditions.

Relation between financial stability and financial balance

In order to determine the pillars of the future concept of microeconomic financial stability, we will analyse the main relations with concepts that are semantically and methodologically close for the company's economy.

Thus, the first relation that we propose for analysis is that between the financial stability and financial balance.

As far as we know, theoretically and methodologically, according to the literature on the financial balance of a company, it can be represented by the following aspects:

- concept of financial balance and the equations expressing it:
    - the notion of financial balance is one of the most difficult financial concepts to define, due to its underlying hypotheses and forms of expression;
    - the hypotheses that help defining and analysing the financial balance refer to:
        - the way in which the financial market works – aspect of the relation between the microeconomic financial stability – macroeconomic financial stability;
        - stakeholder behaviour (shareholders, creditors, collaborators) in knowing the financial situation of the company;
    - within this context, the economist G. Charreaux shows that the financial balance is met if the profitability of investments allows meeting the exigencies in terms of rehabilitation of the shareholders and creditors, taking into account the risks they face; the risks can appear when the financial market doesn't function perfectly; in this case, their behaviour towards the situation of the company changes:
        - the shareholders, if the company is listed, operate with their shares;
        - the creditors are reluctant in granting loans;
        - the collaborators enhance their prudency in their relations with that particular company;
    - in terms of the company, the evaluation of the financial balance is related to its objectives, which are:
        - proper operation of the company within the context of the set objectives;
        - provide a satisfactory profitability for those who provided the resources required for the economic activity;
        - economic growth, diversification and development, depending in the opportunities.

All these subordinate to the major objective of the company: *maximize the value of the company*;

- the financial balance also depends on the financial flexibility, which is the capacity of the company to mobilize liquidities in a short time. This presume:
    - a proper financial structure;
    - arbitrage between the size of own capitals, debts and their cost, which ensure financing strategic or commercial investment opportunities; in other words, it monitors the way in which the company uses its own resources or the borrowed resources.

We may say that for a company, the financial balance appears like a state or like a system of partial states which covers all the patrimony elements and financial results of its activity; in order to evaluate it, one must analyse all the partial states, their proportionality and relations.

As part of the economic balance, the financial balance is given by the equality between the economic capital and the resources that make it, which, in terms of dynamics of company's activity, translates into the equality between cashing and payments, or, in terms of results of the economic activity, translates into the equality between funds and resources.

As a last group of conclusions, we can discuss about the financial stability in the microeconomic field using the following points:

- generally speaking, we can describe the financial stability as a situation which could appear during the evolution of a system as a result of the economic relationships between the named system and the market; this result could be caused, in most cases, by improperly predictability of the market and also of the system evolution in the named market;
- as a continuously result of such first situation – detailed as a risky economic financial stability situation of the named system – could appear phenomena of shocks transmission in the market, especially in the directions of the systems being in economic relationships with the first risky one; in such case, if the economic moment of shock transmission meat the second line systems in a hard economic situation of evolution – as a result of the market economic relationships – could appear a result of the first risk from the first line system measured in the second line systems which could enter in a risky situation of financial instability;
- such situation could be just a temporarily one or much gravity situation which could persist a period of time causing other risky problems for the named system;
- if we extend this model of the risks transmission in the market, the result could become of a high level of gravity and – as a high level of the risk – the market could be affected by a hard financial instability situation which could block, for a period of time, the normal cycle of demand and supply;
- so, it is very important, for any economic system, to make their own economic predictions starting from the macroeconomic ones; in other words, the financial stability problem of a microeconomic system is also a problem of the economic health of the named system and a problem of the economic health of the macroeconomic one;
- it is generally accepted that in the real evolution of any economic system could appear economic moments of very low level of risks and also economic moments of risky matters; even the system is a macroeconomic one or a microeconomic one, this problem consists of two main points:
    - it is very important to exists conditions and instruments for a very good level of predictability and regarding this point it is very important to exists a consolidated functional relationship between the macroeconomic policies administrative level and actors who build the main part of the economic evolution;
    - it is also very important for each system – in part – and for the whole market system – as a functional aggregated and integrated system – to exists instruments and policy ways for absorbing the shocks and regarding this point it is also very important the economic and help relationships between the systems of the market, including the macroeconomic one, and it is at the same importance to have a very good financial intermediation function in the market; regarding this last point, we could observe, also by studying the actual situation, that the financial intermediation function in the market is now diminished in comparison with some years ago when the commercial banks products and services portfolio was closer to

a very good financial intermediation function in correspondence with a better situation of financing products related also to a better situation of demand and supply from the market; in other words, a low level of economic performance, as the market has, generally all over the world, now is in a direct relationship with a risky general situation of financial instability;

- regarding the last point of this discussion, it is also important, for each economic system in the market to predict and quantify the possible risk of financial instability, either from the point of view of the period of time or regarding the gravity level and to appeal to the market specialized institutions and policies for solving the named situation before starting the shocks transmission mechanisms;
- as a last part of the conclusions, the financial stability problem has a more important aspect – namely the risk of the financial instability – and it is not sufficient studied yet because this very new problem appeared as a gravity problem of the whole market simultaneously with the diminishing of the economic performances as it was already discussed; so, a definition for the financial stability/instability is not ready yet, various institutions and specialists have constructed their definitions starting from their field of interest and that's why these definitions have accents in one or other aspect, all of them being very correct and important way for future studies in the named problem; in the same respect, the present analyse also appreciates the actual definitions and try to propose another one, as follows: *the financial stability is a situation which could appear during the evolution of a system as a result of the economic relationships between the named system and the market; this result could be caused, in most of the cases, by improperly predictability of the market and also of the system evolution in the named market; the microeconomic financial stability is also an appreciation of the general financial and economic situation of the company, in qualitative terms, including, as necessarily, the financial equilibrium, the administrative capacity for the activity evolution and risks management – all of these considered in the direction of reaching the performance*.

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