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The Effect of the Financial Crisis on the Jordanian Industrial Sector

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Abstract

The International financial crisis caused the recession of the industrial sector in most developed countries. The effect of the crisis in the developing countries was different. This research aimed at investigating the effect of international financial crisis on industrial sector in Jordan. Different financial ratios were estimated using the financial statements of the industrial enterprises for the period 2000-2008. The financial data were classified to two periods. The first period 2000-2005 and 2006-2008 for this purpose. The results show very slight effect on the industrial sector in Jordan results of the limitations of most companies on their activities as a part of risk management policy.

Keywords: Financial crisis, industrial sector, ratios,

1. Introduction

The financial crisis started in 2001-2002 in the form of mortgage crisis in USA due to real estate crisis represented in high prices, low supply of homes, strict lending, which leads the US government to facilitate the process of lending by banks and increase the number of banks for mortgage lending. Mortgage lending banks extended lending without regard to borrower ability to pay. The sales' agents attempting people borrowing by paying the first installment and then paying a fixed premium but the payments increases as the interest rates of banks increase.

Then the real crisis starts when banks started to sell these loans to companies within and outside USA. These companies used these loans as insurance letters for other companies. Some boxes have been established for these loans. These loans started to be sell and purchase forming stock exchange. The speculations on these boxes started from companies and banks according to their financial capacities. Different economical structures has been built relying on one origin which is the mortgage loan insured by the lender bank. The origin of this loan is weak and caused the damage of the following economical circle built on this loan. At the beginning of 2008, the signs of crisis started. Huge number of borrowers lost their ability to pay their loans. The number of these borrowers reaches millions in 2008. This causes the large companies to fail meeting their commitments. Some large companies asked for financial help while many other companies announced their bankruptcy.These events expanded to reach other developed countries and developing countries because of the economical connections with USA.

The global financial crisis has now stretched across the world; a crisis which emerged in developed countries has already spread to the developing world. Forecasts of growth in developing countries have been downgraded significantly in recent weeks even from those made two months ago. The first formal announcement of the problem was in USA, but within some days, the other developed and developing countries started to report the consequences caused to their countries' economical conditions. The first countries followed the United States as being affected by the crisis was the developed countries. The industrial developed countries were highly affected by the international financial crisis including United Kingdom, Germany and Japan.

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The other countries affect of the crisis through its economical connections with the USA economical market (Al-Mahdi, 2008). Banks in other developed countries and developing countries are connected with huge deals with banks of USA. These deals are represented in reaccrediting of the bank cash assets in USA banks due to high interest rates. The failure of the USA banks affected lead to other foreign banks loose of their deposits.

On the other hand, some companies and banks involved in this crisis through their reassurance for the mortgage loans made by the large mortgage financing banks in USA. The bankruptcy of USA banks lead to the loose of these companies and other banks to loose their financial power to support their processes.

For Arab countries, the major effect was limited to the oil markets. The large consumer of oil is the industrial countries. The international financial crisis leads to decrease the demand on oil which causes sharp decrease on oil prices in the international markets. The crisis has effect on the different economical activities, through its effect on liquidity, the availability of raw material and the contact with foreign countries (Alsumaria, 2008). This research aimed at investigating the effect of the financial crisis on the industrial sector in Jordan as one of the important sector that contributes to the Jordanian economy.

2. Methodology

Financial records of industrial companies were taken from 2000 to 2008. The records were divided to two categories. The first category included the years 2000-2006 which existed before the appearance of the international financial crisis, while the second category included the financial records of the industrial companies from 2006-2008.

Financial analysis of the industrial companies carried out to measure the effect of financial crisis on these companies. The financial ratios included the cost of equity before and after the crisis, cost of debt, market value, and par value to market value, beta, the coverage of interest, and the returns on assets.

3. Results and Discussion

The results show that the cost of equity remained as it is, because most of the industrial companies are not connected directly to the foreign companies outside Jordan. The market value of companies in the industrial sector remained the same (7.053), but the par value to the market value dropped for the industrial companies in Jordan from 1.0836 to 0.967. This indicates that the commercial value of different industrial companies has been changed due to the low demand on shares of these companies in general. Beta value has been decreased by 2% after the financial crisis, this decrease is may be a result of the low demand on industrial companies stocks after the crisis and reflects the low security of the market after crisis. In other words, the risk of investment has been increased in the industrial companies compared to the period before the crisis.

Table 1: The effect of financial crisis on companies' value

Variable	Mean	St.Dev.	Median	Low	Highest
	2000-2005				
Cost of equity	0.1944	0.4039	0.1235	-1.5323	4.3960
Change in par value	6.9970	0.6852	6.9199	5.3979	9.0347
Par value to market value	1.0836	1.0421	0.8559	-4.4686	8.8500
Beta	0.5633	0.6073	0.5050	-1.9290	4.9970
	2006-2008				
Cost of equity	0.1943	0.40568079	0.123394	-1.532349687	4.39599177
Change in par value	7.053141	0.644336574	6.998586	5.62838893	9.03468219
Par value to market value	0.967558	0.834294869	0.84488	-4.46862375	7.4354881
Beta	0.543602	0.587289493	0.5365	-1.929	4.997

The cost of debt for most companies has been increased from 0.1108 to 0.0773, which indicates that most companies decrease their depts to decrease the financial consequences. On the other hand, most companies decrease their dept as they stop expanding their industrial activities due to markets recession.

The return on assets has been increased from 192.034 before the crisis to 33.7. This reflects the retardation of profits for most companies especially in 2008 where the effect of crisis took place widely. The total assets for industrial companies kept the same which reflects the minimum expansion of these companies in their industrial activities.

The continuity of profits decreased from -0.4166 to -0.7850 which indicates the profits for the industrial companies decreased after the international financial crisis.

Table 2: The effect of financial crisis on industrial companies' depts

Variable	**Mean**	**St.Dev.**	**Median**	**Low**	**Highest**
	2000-2005				
Cost of dept	0.1108	0.3068	0.0548	0.0001	4.9988
Financial leverage	0.1608	0.1456	0.1171	0.0001	0.8269
Interest coverage rate	0.0434	0.1133	0.0398	-0.6287	0.4693
Return on assets	192.0341	1387.8685	3.7084	-3174.1479	19064.1758
Change in total assets					
	2006-2008				
Cost of dept	0.077258063	0.081991964	0.065535	0.000935	0.907788
Financial leverage	0.187298574	0.129837054	0.188152805	0.000447	0.648608
Interest coverage rate	0.042659971	0.08627334	0.042531466	-0.31631	0.469341
Return on assets	33.69910671	104.3046551	5.81562	-478.025424	1207.575135
Change in total assets	7.213349555	0.581393349	7.13	6.09	8.63

The industrial companies reserve specific range of incomes despite the international financial crisis. This is because the deals and contracts of most industrial companies in Jordan depend on the local market rather than the international market to precede their businesses.

The losses events in the industrial companies decreased slightly after the crisis as results of the high cautiousness has been shown by these companies to deal with the international financial crisis. Most industrial companies manage their deals to avoid any losses. On the contrary, most of industrial companies in Jordan benefit from the prices drop worldwide in the investment of raw materials. The decrease of oil prices also decreased the costs of production for most industrial companies in Jordan.

The companies' shares market value has been affected because of the low demand on stocks in the stock exchange market. The decrease of low stock price. This decrease occurred after the formal announcement of the crisis in the USA after the mid of 2008.

The cash flow for companies decreased slightly after the crisis but the decrease does not reflect high shock for this sector in Jordan. The value of cash flow dropped from 0.44 to 0.43 only.

The previous results are similar to that find by Muslomov and Karatas (2001) who find that the industrial sector was the least affected by the Asian financial crisis in Turkey. They justified these results due to the low connection of most industries to abroad economics especially for food and beverages industries.

A research was done in Republic of Korea (ROK) on small and medium enterprises found that much of these enterprises withdraw from market as results of the international financial crisis (Kwon, 2009). He justified the withdraw of these enterprises as a result of the bankruptcy of banks. In Jordan, the effect of international crisis on banks was small, that most of local banks were able to deal with crisis. The stability of local banks in Jordan helps the industrial enterprises to stand the crisis without much effect on them.

Klingebiel et al. (2001) found that the stock prices of companies were highly affected due to the Asian financial crisis. Most of stocks of companies dropped due to low exchange in the stock exchange markets. These results are similar to the results found in this research concerning the market stock price of industrial companies.

In fact, market stock prices dropped down for most companies in different sectors especially after the announcement of the international financial crisis. This event happened because most of dealers were waiting the consequences of international financial crisis on the local companies and enterprises.

Inside Jordan, the effect of the international financial crisis was very minimum on industrial sector because of the limited exporting goods abroad as these companies depend on local market.

The financial leverage increased for industrial sector from 0.168 to 0.187 after the crisis. This indicates that the attitude of companies to use dept to cover its activities increased. This increase of use of dept does not mean necessarily the low liquidity available at these companies. This may reflects powerful companies concerning financial management, which is represented through the value of interest coverage in these companies which remained close before and after the crisis.

4. Conclusion

The international financial crisis leads to recession of productive sectors in industrial countries which lead to sharp decrease of oil prices in international market. The low ability of citizens to pay as a result of crisis and the recession of banks to lend cause recession of different industries specially in the origin countries of the crisis.

The economical consequences of the crisis will be witnessed very clearly in 2009 represented in low growth rates and bad economical performances. The development of different countries will be affected because of low allocations for the development process as these liquidity will be used to support the financial institutions.

The international financial crisis left wide effect on international industries because of banks bankruptcy. Most international industries decrease their productions and their workers as a result of the crisis. The major effect of crisis was on the developing countries. In Jordan as one of the developed countries, the effect of financial crisis was minimum limited to the decrease of industrial activities of some enterprises. Some other enterprises benefited from the crisis through the low prices of oil and raw material entered in these industries.

Most of the effect evolved of the international crisis was on the stocks prices as a result of low demand on industrial companies stock in Amman Stock Exchange Market. The performance of most enterprises did not affected by the crisis, except the internal arrangements of these enterprises to avoid liquidity shortages.
The crisis affects the extent of activities of some enterprises, specifically those enterprises which rely very much on exporting to other countries. The recession of production in most companies did not appear through decreasing the working labor of these companies or the announcement of bankruptcy of any of the industrial companies in Jordan.

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