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Financial Crisis of 2008 And Performance Of Firms (A Case Of Listed Firms On Karachi Stock Exchange)

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Abstract

In this research work it is examined the effect of financial crisis of 2008 on firm performance. Total 98 companies are examined from sugar, cement, motor vehicles, trailers and Auto parts, fuel and energy and coke and refine petroleum products. Data is secondary in nature and is used from balance sheet analysis of listed firms non-financial in nature. Time period is from 2007-2011, the operating, accounting and market performance are used for market performance. For operating performance used sales change and return on assets, accounting performance are calculated by EBIT margin and for market performance are used TBIN's Q and KSE-100 Index indicator and from result conclude that in era of financial crisis 2008 some firm performance are decline and at same time some firm performance are improved unexpectedly. Firms with decline performances are high risk exposure while improved performance firms have less risk exposure. At the end it is find that the financial crisis impact is not clearly determine to change firm performance negatively.

Introduction

As we know that the financial crisis was start in 2007 in united states also involved financial institutions in other countries, through trade channels and in some cases through remittances falling of workers developing and emerging economies were affected. This leads to turned the financial crisis into the global economic recession, the results of its effect was as in the developing economies though it was indirect effect such as developed countries where the result effect these economies directly. The expert discussed that these are the worst financial crisis after 1930, stock market downturn around the world, big threat for the shutdown of large financial institutions, wealth of consumer decline, key businesses were failed, and leads to the big problem of liquidity. The word financial crisis means the situations where financial institutions/ assets suddenly loos to great level their values. The main theme of financial crisis in west has dominant effect on the liquidity in the world credit market and banking system. The financial crisis have some direct impact on FDI, size of remittances and bilateral assistance as well indirect impact such as export of Pakistan fall to a great extent such the import of developed countries fall in this time.

In such a crazy situations environment the enterprise risk management play an important role, the risk management concept was introduced in 1950s and developed in different fields in today mature format. Though it cannot protect the business from the severe situation but it is concluded that it is not the fault of risk management approach but it's due to its incorrect implementation by managers. Risk management play an important role in the success of business and its decision making process. Paul (2012) as according to the definitions of institute of risk management as risk management is a process which help the organizations to understand, evaluate and take actions on their risks to increase the probability of success and to reduce failure on the other hand. As the risk management techniques and tools use and it achieves hazard, control and opportunity managements in very successful way.

As we know this risk means uncertainty it affect to a great extant the expected return of individuals and firms that way its management is necessary and its approach is now become mature and more sophisticated as explained by Paul (2010) in his book that it start from hazard management developed to control management and now in the form of opportunity management. The performance of firms plays an important role in the economic development of all countries across the globe. The financial performance is measure by different ways and it is examined that various factors affect performance in every economy.

Lajili and Zeghal (2005) find that the major objectives of enterprise risk management are shareholder value increase, to achieve this improve capital efficiency by allocation of corporate resources. Enterprise risk management exposing areas of risk to support decision making and build investors' confidence by creating stable financial environment to show sound risk management practices by organizations.

As we know that the financial crisis leads to global crisis in 2008 and some research study available about its effect on the different economies. Pakistan economy is also effect due to this crisis because it is also part of global economy, to study financial crisis 2008 effect on financial performance of listed firms on Karachi stock exchange in Pakistan.

Literature Review

Smithson and simkins (2005) add a review and mention to examine the value of risk management, focused on the relationship of value of firms and risk management. Total studies under considerations were ten, out of these ten five related with exchange risk management and interest rate in industrial corporations, one in financial institutions with same variables. Three of them were in commodity producers as commodity risk management and one is related with commodity price risk management. For nine studies used the Tobin's Q for firm value as proxy.

Beasley, Pagach and Warr (2008) investigate that univariate two days average market return has no significant but the multiple regression shown significant relation of firm characteristics and equity market return.

Pagach and Warr (2011) study that firms adopt enterprise risk management for economic benefit directly.

Hoyt and Liebenberg (2011) conclude from research work that there is positive relation of enterprise risk management with the value of firm. Enterprise risk management premium is statistically as well economically significant.

Quon, Daniel and Michael (2012) examined that increased volatility in the business era leads that the traditional approach is insufficient and the risk management is fragmented for risk. Its result leads to generate the enterprise risk management, early study of enterprise risk management applied in the internal control and corporate governance scenario. Enterprise risk management and its relation with firm performance have little attention from researchers, when performance of firms changed means become down in 2008-2009 due to financial crisis and the global recession. It also mentioned that risk management strategies have minor attention in 2007-2008. Conclude that enterprise risk management cannot affect business performance. Also mention that it cannot predict its performance. Examined in this study the non-financial listed firms on Toronto Stock Exchange, used market, operational and accounting measures for 2006-2009 for performance of firms.

Research Methodology

As mentioned that main objective of this work is examined the relationship of financial crisis 2008and financial performance of listed firms. Data used secondary in nature and is of financial statement analysis of listed firms on Karachi Stock Exchange. Data period is from 2007-2010, for the 2007 result measurement 2006 as base year, it used for the purpose to clearly provide the picture of performance in pre and post area of financial crisis and also in financial crisis time.

Analyze the operational, accounting and financial market performance of firms by using different techniques such as for operational purpose used change in sales from 2006-2010. Accounting performance calculated by change in EBIT margin and financial market performance by Tobin's Q used such variables for study Tony et al, (2012). Also used market return as financial market performance indicator, for operational measure also use return on assets. For the calculations of these variable used the simple approach but for Tobin's Q use the approximate q approach. Approximate q has same results as the common approach of Tobin's Q as developed by Chung and Pruitt (1994).

Sampling techniques are used for this work is convenient because it's based on the concept of data availability of firms easily and complete for the study period. Those firms for which complete data is not available are excluded from the sample.

Results and Discussion

For the performance measurement used different performance measuring indicators such TBIN Q, change in sales, EBIT margin, ROA and KSE-100 Index as additional market performance indicator. The discussion section of this work is discussed here. First discuss the operational performance as measured by change in sales and return on assets.

As already mention sample size is ninety eight listed companies from different sector of Karachi stock exchange in methodology section. The sale change result shows that forty one company's sales decrease from 2006-2007 while fifty seven companies sales increased by comparing the sales change from 2006 to 2007. In the years 2007-2008 the number of decrease sales companies are twenty two and positive change companies are seventy six, but in 2008-2009 the number of decrease sales companies jumps to forty six companies this indicates the financial crisis impact on the performance of these companies in Pakistan market and this percentage in this study is 51.11 percent and 48.89 percent companies sales are increased. The impact of crisis on the negative changes is became less in coming time period as 29 and 24 percent in 2009-2010 and 2010-2011 respectively. This concludes that some companies are having more risk exposure in this time but unexpectedly some firms have less or not immediate negative impact on their sales.

At the same time the operational performance are measured by another indicator return on assets, from their analysis it is clear that in 2006-2007 changes period 44 companies having negative sign of ROA and the 54 having positive. The level of negative change is remain constant for the time 2007-2008, 2008-2009 and 2009-2010 of 38 companies while 60 companies has positive ROA with unexpected results for this time period especially for 2008-2009. The level of negative perform companies decline to 35 firms in 2009-2010 that indicate the positive trend in performance. This means the companies of high or positive ROA have less/low level of risk exposure while the low ROA companies have high risk exposures.

The second aspect of this work discussed with the accounting performance measured by changes in earnings before interest and tax, results conclude that 32 companies are negative EBIT from 2006-2007. The number of negative performance companies are 24 in 2007-2008 indicate the financial crisis has shown its impact and in 2008-2009 the number of companies are reach to 22 and again have a slight increase of some firms in 2009-2010 but in 2010-2011 the performance of only 20 companies are negative and the number of positive companies are 78. It means the risk exposure is low on this performance and has less immediate impact on performance.

The third aspect of this research work is financial market performance differences as measured by Tobin's Q and Karachi stock exchange 100 Index as another market performance indicator.

From Tobin's Q result it is conclude that the performance of only nineteen companies are decline in the time period of 2006-2007 and seventy nine companies have increase in their financial performances. At the period of 2007-2008 the firms performed well only 15 firms of the sample have decline in performance and 81 have increase in their performance. The performance of firms improves in the consequent time periods. Only eight firms have decrease in 2008-2009 time period and it indicate that the performance are improve in the crisis time period which indicate that the risk exposure in this era is low. In 2009-2010 the performance of 11 firms decline but in 2010-2011 it is remain good and 12 firms have low performance and other firms has positive trend in their performance. At the same time period get the data of market index which have upward trend in 2006-2007 times, in the time period of 2007-2008 the market performance decline which show that there is immediate effect of financial crisis on companies performance. The result shows that the trend became positive of performance in 2008-2009 but again decreases in 2009-2010 market performance and become less in 2010-2011. This also indicates that our market have efficiency which is more sensitive to changes in environment.

Conclusion

From this research work it is concluded that the effect of financial crisis of 2008 on firm's performance are mixed. Used operating, accounting and market performance indicators for this study, from these results conclude that some firms face performance improvement problems as mention that their performance are decline at that time while some firms have positive performance means their performance are increase at that time. At the end I conclude that in this research work cannot conclude that risk exposure/financial crisis have effect on the firm performance.

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