CHAPTER - I

INTRODUCTION
1.1 INTRODUCTION

Industrial development and economic development are the two closely tied-up indicators of the prosperity and growth of a country. In this modern dynamic world of globalization and competitiveness, industrial development has a significant effect on the overall development of a country, as it helps in realizing the rise in the social and economic standard of the country. In Jordan too, industrial development has contributed a lot in creating employment opportunities, export and import substitutions, boosting up the growth rate of national output, raising the standard of living, improving health consciousness and raising the level of education. Jordan began to promote industrialization during 1950s and 1960s. The industrial sector in Jordan has always remained important for its potential in the past and its current role in the economy. Thus, industry is regarded as the cornerstone for the development and enhancement of the Jordanian economy.

In Jordan, industry has gone through several phases of transformation due to the political instability in the Middle East, underdevelopment of transport, and lack of infrastructural facilities. Industrial development of Jordan can be better achieved, if natural resources can be efficiently utilized and skilled personnel can be developed. Insufficient telecommunication, inflation, scarcity of water, scarcity of electricity, devaluation of the Jordanian Dinar and the Middle East crisis have been some of the major hindrances in the progress of industrial development. In spite of all these inconveniences, Jordan’s economic development over the past 50 years has been characterized by significant accomplishments at the economic and the social levels, even though it faced many ups and downs during its growth as a developing economy.

It is an accepted fact that the industrial prosperity and success are linked directly or indirectly with efficient management of working capital. But a developing industry generally faces the problem of either inefficient utilization of resources which are available to them, or scarcity of adequate resources. Among all the resources, one of the scarcest productive resources is capital,
and capital plays the most pivotal role in overall corporate management of an industry. Thus, management of working capital in a balanced and efficient manner can lead to the survival of the industry and it also further helps in protecting the purchasing power of assets and maximizing the return on investment. But it has been found from many studies that maintaining an adequate amount of working capital is one of the basic problems of modern industrialization. Therefore, the major consideration in Jordan is to understand, evaluate and analyse management of working capital, so that appropriate changes can be made to make it more efficient and productive.

1.1.1 Location and Topography

Jordan is a young and modern country enriched with an ancient civilization dating to the pre-history ages. Amman, the capital of Jordan is an ancient Roman city known as Philadelphia that was built on seven hills, similar to Rome. Its Citadel and the Roman theatre remind us of its history. Jordan is located to the east of the Mediterranean and to the north west of the Arabian peninsula between north latitude 29°11' and 33°22’ and east longitude 34°59’ and 39°18’. It is centrally located at the heart of the Middle East, with Israel and West Bank bordering to the west, Syria to the north, Iraq to the east and Saudi Arabia on the east and the south.

The total area of Jordan is approximately 96,188 square kilometers including the Dead Sea. To the north of Dead Sea, lies Ghour which is a highly fertile land, the desert plateau at the east is rich with its beautiful scenic natural heritage, such as the site of Wadi Rum. In the west, the Jordan river flows through its fertile valley into the Dead Sea, which is the lowest point in the world. In the north, the boundary between Jordan and Syria is located at the Yarmouk River. At the far south, the port of Aqaba, gives Jordan a narrow outlet to the Mediterranean Sea (Red Sea).

Jordan comprises a variety of contrasting and fascinating features of climate which are usually found only in large countries. It considerably varies from region to region. The climatic condition is that of the Mediterranean basin, i.e., hot and dry in summer and cold and rainy in winter. Seventy five per cent
of the country can be described as having a desert climate with less than 200 mm of rain annually.

The population of 4.6 million in 1998 is a mixed population with 95 per cent Muslims and 5 per cent Christians. Arabic is the main language of the country but English is also widely spoken and used as a Second Language. The literacy rate of more than 85 per cent is one of the highest in the developing countries.

1.1.2 Geo-Political System

The Hashemite Kingdom of Jordan is a constitutional monarchy represented by a democratic government. Jordan enjoys a most stable political system. His Majesty King Abdullah II Bin Al-Hussein is the head of the state and Prince Hamzah Bin Al-Hussein is the Crown Prince. His Majesty King Abdullah II was appointed by his late father King Hussein Bin Talal by a royal decree on 25th January 1999.

The King exercises his executive authority through the Prime Minister and the council of Ministers, or cabinet called “Majlis AL-Ummeh” with its two houses. The Upper House or the Senate called “Majlis AL-A’ayan” consists of 40 senate members who are appointed by His Majesty, and the other house, i.e., The House of Deputies called “Majlis AL-Nawwab” consists of 80 deputies who are elected by the Jordanian citizens every four years. The Kingdom is divided into 12 governorates, which are governed through their respective Governors, except for the regional councils. The judicial branch, is an independent body of the government.

1.1.3 Economy

Jordan, despite a dearth of natural resources and local skills, and an unfavorable geo-political situation, the Gulf crisis and the emergency relief given to the Palestinian refugees, has experienced a remarkable unexpected economic growth. Jordan’s economic development over the past 50 years has been characterized by significant accomplishments at economic and social
levels although it has experienced many inconsistencies during the process of its growth as a developing economy.

Since independence the real Gross Domestic Product (GDP) registered a high growth rate. Jordan succeeded in setting up the basic infrastructure by establishing a number of industries and implementing irrigation and agricultural projects. Educational and health services were also developed and the institutional and administrative framework for development was upgraded. However, the productive base remained low and therefore, the domestic production of goods and services was insufficient to fulfill the public demand which resulted in importing a good amount of consumer and capital goods. Because of all these reasons, a chronic deficit in the general budget and an increasing deficit in the trade balance has been seen. These deficits, which are constraints in the path of desirable growth have been filled by many foreign aids. Foreign assistance plays an important role in the growth of the economy. Jordan's economy follows free economic policies. It allows a free capital market, open frontiers of exports and imports, and easy convertibility of national currency.

During fifties, Jordan entered the stage of single project planning. The sixties show the formulation of the five-year programme, which was later reformulated into the seven-year programme of 1964-1970, but was again suspended because of the occupation of the West Bank by Israel in June 1967. This plan aimed at reducing the deficit in the trade balance and the dependence on foreign assistance for budget support. During this period the Gross National product (GNP) increased by 7 per cent p.a. which resulted in reducing the unemployment, but in 1967, the Arab-Israeli war hampered the economic programs. Real GDP at factor cost grew during this period at an annual average rate of 4.6 per cent, notwithstanding the fact that in 1970 real GDP at factor cost dropped by 11 per cent as against the previous year. GNP at current and market prices rose from JD 142.5 million in 1967 to JD 221 million in 1972 at an annual increase of 9.2 per cent, equivalent to 4.2 per cent at constant prices.
Plan activities resumed with the formulation of three year plan, covering the period of 1973 to 1975. This plan aimed at tackling the problems that arose from the occupation of the West Bank. It also concentrated on reactivating the economy and enhancing employment opportunities by the creation of 70 thousand jobs. Actual capital expenditure amounted to 96 per cent of the JD 179 million envisaged by the plan. The real average growth rate of GDP at factor cost during the plan period was 5.9 per cent. The plan as a whole succeeded in achieving its main targets of reactivating economic activities and stimulating economic growth.

The first five-year plan covering the period of 1976 to 1980 was postulated in order to bring about an increase in the annual real growth of GDP by 12 per cent, increase in real domestic revenues by 16.5 per cent, a reduction of the trade deficit from JD 153 million in 1975 to JD 131 million in 1980, and to bring balanced development of all regions, but the plan fell short of its aims in many respects.

The second five-year plan, covering the period of 1981 to 1985, assumed the continuation of existing positive trends, such as the inflow of Arab aid, capital aid and the favorable development of trade relations. This plan envisaged a real annual growth rate of GDP of 11 per cent at factor cost.

The third five-year plan covering the period of 1986 to 1990 was designed to reinforce the national economy's own potential and enhance its efficiency at the adjustment stage. It emphasized that individuals and private sector institutions be given the opportunity to utilize their capabilities and contribute more effectively to development and aimed at an improved performance of the public sector. The plan also aimed at realization of GDP growth rate at 5 per cent p.a. During this period, the total volume of investment was expected to reach 29 per cent of GDP at market prices.

During the end of the third five year plan, Jordan's economy experienced two economic crises: the devaluation of Jordanian Dinar in 1988 and the Gulf war in 1990. Thus, the country had to devalue Jordanian Dinar due to a sharp decline in the foreign exchange reserves with the Central Bank.
There was a drop in the Arab financial assistance and also in the remittances of the Jordanians working abroad. Exports to the Arab countries also declined, specially due to the closure of Kuwaiti and Iraqi markets. During this period of economic crisis, the government was not able to serve its foreign debt and there was a sharp decline of 9.1 per cent in real Gross Domestic Product. As a result, this plan was suspended again. During the period 1989 to 1993, an economic structural adjustment programme was launched to revitalize the economy and to overcome the economic crisis. This programme showed notable success in the first year but was again interrupted in the second year due to the Gulf crisis. The Jordanian Dinar lost 60 per cent of its value in 1990. Thus, the annual average growth rate was negative during this period.

After four years of interruption in planning schedule, Jordan adopted an amended economic adjustment programme of seven years covering the period of 1992 to 1998. It was resumed to tackle the structural imbalances in the balance of payments and budget in order to achieve fiscal and monetary stability. It was also designed to build strong foundations for sustained economic growth with relatively stable price levels.

The present five year plan, covering the period of 1998 to 2002, was launched for enhancing growth of industrial sector by 7 to 9 per cent p.a., to increase exportation by 11 per cent p.a., per capita income by 10 per cent p.a. and employment opportunities by 8 per cent p.a. etc.

Thus, we can conclude from the above discussion that the economic planners have set certain objectives viz., to reduce the rate of inflation and the cost of living, to be more cost-conscious, to attract Arab investments to circulate the money internally, to reduce unemployment and promote further Jordan's regional role during the plan schedule.

1.1.4 Industry

Industry is one of the main contributors to socio-economic growth and the main generator of national income of a country. Like many other
developing countries, Jordan also began to promote industrialization during 1950’s and 1960’s. The industrial sector in Jordan remains more important for its potential than its past or current role in the economy. Industrial development of Jordan can be better achieved, if natural resources and the skills of personnel can be efficiently utilized. Insufficient telecommunication, inflation, scarcity of water, scarcity of electricity, the devaluation of the Jordanian Dinar and the Gulf crisis had been major hindrances in the progress of industrial development. However, the overall development of the industry is far beyond expectation, inspite of all these inconveniences. The industrial sector of Jordan has access to finance from many regional as well as international channels such as the World Bank, Arab Monetary Fund, Islamic Development Bank and domestic institutions like Jordan Investment Corporation, The Social Security Corporation, Industrial Development Bank, The Commercial Bank and Non-Banking Financial Intermediaries.

When Jordan was formed after the partition of Palestine in 1946, the industrial development began to take root even though the industrial sector was relatively underdeveloped and slow due to scarcity of natural resources, and capital, political instability and other infrastructural difficulties which caused retardation in the industrial development. But by late 1950’s, the situation had improved to some extent, as there was increase in private initiative, assistance of foreign aids and promotional initiatives undertaken by the government.

From 1959 to 1966, the industries mainly depended on small scale and simple working methods, without using more advanced technologies and tools. The average annual rate of GDP was 18 per cent during this period.

For the industrial sector, the period 1967 to 1971 experienced a very limited development due to the cycles induced by changing political circumstances. Recession in the aftermath of defeat in the 1967 Middle East War was followed by recovery during 1968 to 1969, then again cut short by Civil War in 1970 to 1971. By 1971 the value of East Bank industrial production probably was not much different from its 1966 level when measured at constant prices.\(^4\)
Between the 1967 and 1974 wars, there was little change in the manufacturing sector, but for industry as a whole, there was one major change, i.e., the expansion of phosphate earning. This was due to the transitory price increase and partly due to the output expansion.

During the period 1972 to 1975, there was rapid growth of industry but due to inflation the expected rate of growth could not be achieved. In Mid-1977, the Jordan Institute of Management attached to the Industrial Development Bank launched an activity to provide training opportunities in industrial management, accounting and marketing. Thus, from 1976 to 1980, 670 new factories were licensed, each with machinery of more than JD 5,000. About 2,300 small-scale and handicraft industries were licensed, each costing JD 5,000 or less. Chemical industries received the largest number of licenses with the building material industry in the second place. Income in the industrial sector at current prices rose from JD 64 million in 1975 to JD 154 million in 1980, at an average annual rate of 27.3 per cent. During the same period, investment in the industrial sector was JD 317 million of which JD 60 million was in the private sector and JD 16 million in the public sector. The remaining JD 241 million was invested by mixed companies having both private and public sector participation. Credit facilities advanced by commercial banks to this sector expanded from JD 15.1 million at the end of 1975 to JD 73.1 million at the end of 1980. Exports of products also rose significantly from JD 29.4 million in 1975 to JD 97.4 million in 1980.

During the second five year plan, i.e., from 1981 to 1985, the government's industrial strategy concentrated on large capital intensive industries. The total value of actual investment amounted to JD 599 million compared to an anticipated JD 759 million by the plan or 78.9 per cent of the plan target. This was because of the economic recession after 1982, which caused a decline in the investment in all the economic sectors. During the same period, GDP was expected to rise to about 30 percent at current prices but the actual growth during the plan period amounted to only 4.9 per cent annually. Thus, the industrial sector contribution to GDP in 1985 was only 19.3
per cent with the framework of industrial coordination among the Arab states, the Syrian-Jordanian company for industry was established and the ministry issued 291 licenses to standard specifications during this period.\textsuperscript{8)}

The industrial sector staged a substantial recovery during 1987. The industrial production index rose to 9.3 as against 1.4 per cent in 1986 and the GDP crept up to 17.5 per cent, the highest among commodity producing sectors. This improvement reflected the expansion in the production of a number of industries. Some 352 industrial companies were registered in 1987 with a total capital of JD 8.6 million as against 246 companies with a total capital of 4.4 million in 1986 (excluding the share holding companies).\textsuperscript{9)}

During 1988, the industrial sector was still under the impact of the economic recession. The income generated in the industrial sector totaled JD 243.8 million, i.e., 3.4 per cent drop compared to an increase of 4.3 per cent in 1987 and the production index dropped by 8.1 per cent compared with 1987.\textsuperscript{10)} The number of new industrial companies registered in 1988 totaled 392 with the capital amounting to 14.4 million.

During 1989, the industrial sector recovered by 7.3 per cent because of the improved competitiveness of Jordanian products. The number of new industrial companies registered reached 404 with a total capital of JD 19.1 million during this year. The contribution of GDP at constant factor cost was 15.7 per cent.

In 1990, the industrial production showed slight improvement as it rose by 0.5 per cent as against the 5 per cent decline in the previous year. Despite the slight increase, the income generated declined to JD 286.7 million as compared to the previous year. As many as 488 new industrial companies were registered with an aggregate capital of JD 16.7 million. The contribution of GDP at constant factor cost increased to 16.9 per cent.

The industrial production during 1991 dropped by 2.9 per cent, due to the fall in income generated from the industrial sector to JD 283.1 million, at constant prices. This represents a decline of 3.1 per cent against a growth of
1.9 per cent in 1990. The reasons for the fall in income was the slackening of external markets, especially those of the Eastern Europe. There were 710 new industrial companies registered with a total capital of JD 46.5 million. The contribution of GDP at constant factor cost slightly increased to 17.1 per cent.

In 1992, the industrial production index rose to 61 per cent and thus the value rose to JD 343.3 million. The main reason for this development was an increase in domestic demand for the products of the industrial sectors due to the influx of new consumers and increase in the process of imported goods at rates higher than those of domestic items. During the same period, new markets were opened up and present ones were expanded; 813 new industrial companies with total capital of JD 101.0 million were registered. The contribution of GDP at constant factor cost was 16.2 per cent.

In 1993, the growth rate registered a rise at 1.6 per cent and the value added registered a growth of 4.5 per cent. The main reason for the reversal was the continuation of unfavorable external demand. During this period, 665 new industrial companies were registered with a total capital of JD 122.3 million. The government gave special attention and concern to create an investment climate that was highly encouraging and stable, which would lead to the expansion of the industry. The contribution of GDP at constant factor cost was 15.1 per cent with JD 309.3 million and the total value of national exports reached up to 79 per cent.

During the year 1994, the industrial expansion was quite high. Custom duties were reduced or abolished on several industrial inputs. To activate the industrialization movement and increase investments in industrial activity, the existing free zones and industrial estates were developed by improving the infrastructure and providing the services required. The industrial sector continued to grow at a noticeable rate during this period. The industrial production index rose by 5.6 per cent and the value added generated by the industrial sector witnessed a real growth at the rate of 7.9 per cent. A total of 648 new industrial companies were registered with a total capital of JD 182.3 million. The industrial sector developed a significant degree of diversity. Thus,
the Amman Chamber of Industry classifies its associated range of reproductive activities into fourteen sectors. During this period, the total value of national industrial exports reached JD 716 million and the contribution of GDP was 17.5 per cent and it contributed around 90 per cent of the total value of national exports.

In 1995, Jordan’s manufacturing base consisted of 9300 companies. The contribution of GDP during this year crept up to 17.8 with JD 416.6 million and the total value of national exports of the produced goods rose to 90 per cent.

During 1996, with establishment of new industries the number reached to 21 thousand. Two joint ventures were established in the industrial sector. An Indian-Jordanian joint venture (with 52 per cent Indian ownership) with 160 million US Dollars was established to produce phosphoric acid. In addition, a Japanese-Jordanian joint venture (with 60 per cent Japanese ownership) with 24 million US Dollars was established to produce fertilizers. Both projects began operations in 1996. Due to the attention given by the government to promoting new industrial sectors with more positive results, the contribution of GDP rose to 18.1 per cent with JD 443.8 million. But the total value of national export of production came down to 84.6 per cent as compared to 90 per cent in 1995.

Thus, the overall industrial development has shown a positive trend in accordance with socio-economic development of the country, but it is still facing a number of problems. The most significant problems are:

i) Scarcity of raw materials and capital

ii) Lack of competitiveness in local industries

iii) Excessive reliance on the domestic and some neighboring Arab markets, to the exclusion of other markets

iv) Lack of appropriate technology and research

v) Scarcity of technical, administrative and marketing skills and capabilities
vi) Difficulty of information exchange among producers of raw materials and intermediate materials, and users of such materials.

vii) Smallness of value added in the manufacturing sector \(^{(12)}\)

Therefore it is realised that the policy makers should take adequate steps to encourage exports, improve the infrastructural facilities to create support in the industrial growth and general development of the economy. This will help in ensuring rapid industrial growth which will have a substantial favourable effect on the development of the economy.

1.2 RATIONALE OF THE STUDY

Industrial development plays a crucial role in the process of modernization and socio-economic development of a country. It also helps in understanding the framework as to how the national resources and factors of production are utilized, how they were acquired, and how the technologies are transferred with the new skills developed. Industry also links together all the economic activities of the society and interacts with them in ways meaningful for the economic growth and enhancement of the national income. Thus, maintaining an industry in a proper and efficient way will enable it to cope up with the drastic changes and advancement of new technologies and scientific inventions. And in order to run full-fledged successful industrial companies, a proper and efficient management of working capital is an essential part of any industrial company. Thus, working capital may be regarded as the life-blood of a business; its effective provision can do much to ensure the success of a business, while its inefficient management can lead not only to loss but also to an ultimate downfall of the company. A deeper understanding of the importance of working capital management and its satisfactory provision can assist in saving materials and maximizing financial return on the minimum capital employed.\(^{(13)}\) The rationale of the study is emphasized by the fact that the manner of management of working capital determines the success or failure of the operation of a business.\(^{(14)}\) Surveys indicate that the largest portion of a financial manager’s time is devoted to day-to-day internal operations of the company i.e., working capital management \(^{(15)}\)
Chakraborty,\textsuperscript{(16)} in his study of working capital management and economic growth mentions that the working capital is of crucial importance not only because working capital takes up a larger part of capital formation but also because optimal utilisation of even the fixed investment depends on proper management and deployment of working capital.

A reasonable rate of return on investment and a good reputation in the business world can be suggested as the two meaningful criteria for viewing the efficiency of a business enterprise. In earning a reasonable return, the working capital plays a vital role.\textsuperscript{(17)} The liquidity and profitability positions of a business concern to a great extent depend on how far the working capital is efficiently managed. It is, therefore, important on the part of the management to pay particular attention to the planning and control of working capital.

Working capital management of a high caliber is essential for the survival of the industry. The postponement of the solution of working capital problems in the industrial company is the postponement of the industrial efficiency and improvement in productivity. The level of working capital and its problems may not be the same with all industrial companies. It is likely that all industrial companies may not show the same level of efficiency in the working capital. Some may show low efficiency, others may show moderate efficiency and some of the industrial companies may show a high level of efficiency in the utilisation of working capital.

From a general analysis, it was found that there is dearth of studies in the area of working capital management. This area has been totally neglected in the industrial companies as well as in the academic field in Jordan. This has also been revealed by most of the senior professors in reputed universities of Jordan. The investigator personally undertook informal discussions with the executive managers of all the selected industrial companies of Jordan to verify the fact. It was found that no systematic and comprehensive study in this field has been undertaken either in the form of articles or research papers or as a doctoral study, though a number of small studies have been completed in the field of profitability analysis, industrial finance, marketing, historical
development of the industrial companies of Jordan, etc. Hence, an attempt is made here to systematically study and analyse facts concerning the working capital management. This study therefore, would be a step ahead in the direction of generating empirical evidence and it will serve as a guide for further research. Thus, this study is thought to be highly imperative.

Keeping in mind the above views as well as the reviews of related literature and research, the present study has been attempted

1.3 STATEMENT OF THE PROBLEM


1.4 SPECIFICATION OF THE STUDY

The title of the present study reads as “A study on the working capital management of the selected large scale public limited industrial companies of Jordan”.

In order to clarify the statement, it is necessary to define important terms used in the statement of the problem.

The phrase ‘Working Capital’ refers to the total current assets of the industrial companies during a particular period of time. Current assets are the assets which can be converted into cash within an accounting year. These are represented mainly by cash balances, accounts receivable, loans and advances and inventories which include raw materials, work-in-process, finished goods, stores and spare parts and miscellaneous goods in the industrial companies.

The phrase ‘Working Capital Management’ denotes the determination of the requirements of working capital, financing the requirements, and efficient utilisation of working capital in the industrial companies. A study on the working capital management is mainly related to the adequacy of inventory, receivables, cash and bank balances, and working capital finance in the industrial companies during the period under study, i.e., from 1987 to 1996.
The phrase 'Large Scale Public Limited' refers to those industrial companies that employ more than 19 employees according to the definition of Statistical Department of Jordan.

For the present study, the term 'Industrial Companies of Jordan' refers only to the manufacturing industrial companies of Jordan.

1.5 CHAPTERISATION SCHEME OF THE STUDY

This thesis has been presented in six chapters:

The first chapter is an introductory chapter which includes details such as introduction, rationale of the study, statement of the problem, specification of the study, and the chapterisation scheme of the study.

The second chapter includes the review of the related literature and its implications on the present study.

The third chapter deals with the methodology followed in the study, i.e., introduction, statement of the problem, objectives of the study, delimitation of the study, sample of the study, sources of data and data collection, methods of analysis in the present study, specific ratios followed in the study, working capital gap and bank finance recommended by Tandon Study Group, and operational definition of the terms used in the study.

The fourth chapter is devoted to the analysis of the theory of working capital management. It includes the concepts of working capital and working capital management, structure of working capital, factors affecting working capital, financing of working capital, and the planning and control of working capital.

The fifth chapter deals with the analysis and interpretation of the data of the study in the light of the specific objective of the study. It is divided into five sections, as follows:

Section I is devoted to the detailed treatment of empirical data on inventory management in the industrial companies showing the adequacy of
inventory, raw materials, work-in-process, finished goods, stores and spares, miscellaneous goods, and planning and control of inventory.

Section II includes the analytical part of receivables management in the industrial companies, showing the composition of receivables adequacy of accounts receivable and loans and advances, and planning and control of receivables.

Section III analyses the cash position in the industrial companies showing the adequacy of cash as per operational requirements, adequacy of cash in terms of liquidity and solvency, sources and uses of fund, management and control of cash, and efficiency in cash management.

Section IV reveals the working capital finance in the industrial companies indicating its requirements, adequacy of working capital finance, sources of working capital finance, and planning and control of working capital finance.

Section V is an analysis of the working capital management in the industrial companies of Jordan, showing in detail the efficiency of the uses of working capital.

The last (sixth) chapter concludes with the major findings of the study, summary, conclusion, policy implications and recommendations for further research allied to the present study.
REFERENCES


