The Effect of Enterprises Characteristics on Transactions risk Exposure Management

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Abstract

The objective of this paper is to investigate the characteristics of enterprises on transactions risk management in Jordanian enterprises. The questionnaire was used as a tool to collect data. The results of this research indicated that the firms' activity is considered the first constraint that affect the transactions risk management.

Keywords: Transactions risk management, enterprise activity, firm size, firms' captial

Introduction

Foreign exchange risk as a part of financial risk is classified to three forms: (1) Transaction risk, resulting from future transactions (sales and Purchases) that are certain to take place but before the company will be able to adjust prices in line with the exchange rate movements. (2) Economic risk, which is any exposure of firms cash flows (direct or indirect) to exchange rate movements. (3) Translation risk, relates to the exposure of a firm's consolidated financial statements to exchange rate movements.

The expressions transaction, translation and Economic risks were first used by Ankrom (1974), other expressions and definitions will be discussed thoroughly later in this study (Brucaite and Yan, 2000). Managing Foreign Exchange Risk involves adopting strategies and using instruments that protect the firm's value and cash flows against the movements of the currencies exchange rates, and this process is done after measuring the exposure to the risk with currencies that are involved in its transactions.Given the significance of this subject and its impact on the value of the firm, questions arise about the implementation of techniques that manages the exchange rate risk in Jordan.

Jordan is a developing country that became the 136th member of the World Trade Organization (WTO) on April 11, 2000, and to achieve that it was embarked on major reforms of its economy and legislationsto promote greater foreign trade and investment.This study will explore the area of foreign exchange risk management with a special emphasis on specific forms of that exposure namely the transaction and economic exposures. Translation is not studied thoroughly because of the small existence of multinational firms based in Jordan that is exposed to such risk. Also the analysis will involve only selected non-financial companies as the sample of the study. Financial companies will be neglected because of the ambiguity concerning their purpose of their use of the hedging instruments.

Currently there is a scarcity of research papers about foreign exchange risk management in emerging markets. Theoretical studies are usually supported by findings from developed countries (Samenaite, 2003). Therefore this study will be distinctive because it will contribute in the increase of the academic studies about emerging markets. Also it concentrates on Jordan, one of the Middle East countries, which makes it one of the earliest foreign exchange risk management studies in this country.

Importance of the study

The change in the currency market will affect the company's domestic market by the advantage that the foreign competitors will get, being able to offer lower prices for the same product in that market. Therefore, the company will face double losses; it will lose part of the domestic market and part of the foreign market.

Exchange rate risk can also expose small firms having only domestic trade activities. This exposure can be resulted from outsourcing trends and foreign competition that made those firms increasingly dependent on the world market main currencies fluctuations.

Literature Review

Jordan, the country of the study, is a developing country, that is and has always been, dependent on the input of external capital, including foreign assistance and remittances from Jordanians working abroad, but Gulf War crisis beginning in August 1990 resulted in that more than 320,000 expatriates returned to Jordan from the Gulf nations, causing the cease of much-needed expatriate remittances that had formed a major source of foreign exchange, since 1992 Jordan's economy started to recover after adopting political and economic policies and privatization programs that attracts foreign investments to support the economy by the inflow of hard currency.
Beside the flow of hard currency to Jordan from the foreign investments and tourism which are considered to be vulnerable sectors, due to the geographic location of Jordan in the middle east effected by the war in Iraq in the east and Palestinian-Israeli conflict in the south and also the terrorism threat to the whole region; the industrial sector in Jordan is considered to be one of the major supporters of it's economy. The major industries in Jordan are phosphate fertilizers, minerals, petroleum products, food processing, metal products, cement and building materials, cigarettes, animal feed and clothing. Additional industries include furniture, pharmaceuticals, cosmetics, paints, plastics, paper and cardboard.

In 1988/89, the Jordanian economy was hit by a devastating exchange rate crisis that nearly halved the living standard of the average Jordanian and left the government heavily indebted. The crisis was the outcome of a protracted history of high fiscal deficits leading to an increasing debt burden, which was exacerbated by persistent overvaluation of the exchange rate and the failure to take corrective measures (Sedik and Petri, 2006).

Methodology

This research was executed on a random sample selected through stratification of large enterprises in Jordan. Questionnaire was used a tool for data collection. The questionnaire included wide range of varieties. For the purpose of this paper the concentration was on measuring the parameters related to the effect of foreign exchange risk on enterprises activities.

Results

Firm's Capital

The capital of the firms was categorized to four periods with a range of 5 million JDs. The first category starts with firms that have a capital of less than one million as Table (1) shows a majority of 44.3% belongs to that category, (19) firms with capital between 1-5 million JDs represent 27.1% of the respondents, as for the category of 5-10 m there were (14) firms and represented 20% . Finally 8.6% of firms had capitals of 10 million or more.

Insert Table 1 about here

Firm's Annual Sales

This variable is measured through periods with a range of 3 million JDs, starting from sales less than 3 million JDs to 15 million or more. Table (2) shows that 29.9% of firms have annual sales of less than 3 million, 37.3% with annual sales of 3-6 million JDs, both categories represent the majority of the sample. While 14.9% of firms are in between 6-9 million, 9% between 9-12 million, and only 3% of firms have sales of 13-15 million. Firms with annual sales of 15 million or more represented 6%.

Insert Table 2 about here

The effect of exchange rate variation of foreign currencies on firms' activities

The highest effect of the exchange rate variation was on sales and revenues as the mean was the highest compared to other activities 3.35. The second effect of the exchange rate variations was on profit, while the lowest effect was on cost with means 2.81 and 2.67; respectively (Table 3) (Figure 1).

Insert Table 3 about here

Insert Figure 3 about here

The Results of Transaction exposure Dimension

Transaction exposure is related to the risk that arises from day to day transactions dealt with foreign currencies that are subject to volatility in value against the local currency.

In order to reach results concerning whether there is a relationship between the company specific characteristics and foreign currency risk management techniques adopted by Jordanian firms, first different techniques were listed then to show how often they were used; answers were coded in a way that if a technique was always used by the firm the code was (5), if usually (4), sometimes (3), seldom (2) and finally if the answer was that the technique was "never used" the code would be (1).

Hypothesis testing

Ho: *There is a significant statistical relationship between firm size and management practices toward transaction exposure in the Jordanian environment*.

i. The effect of capital size of the firm on managing on transaction exposure risk

Table (4) shows that there is no significant statistical relationship between capital size of the firm and its techniques used to manage transaction exposure. With a significance level of (0.74) which is larger than (0.05).

Insert Table 4 about here

Insert Table 5 about here

ii. The effect of sales volume of the firm on managing on transaction exposure risk

The result of the sales volume character and its relation to the use of transaction exposure management techniques also [as shown in table (6 & 7)] indicates an insignificant statistical relation. The significance level for this test is (= 0.218 > 0.05), which is not acceptable.

Insert Table 6 about here

Insert Table 7 about here

Both results assert the ***rejection*** of the hypothesis of the relationship between firm size and the management of transaction exposure.

The effect of firm activity on managing on transaction exposure risk
H0: There is a significant statistical relationship between industry groupings and management practices toward transaction exposure in the Jordanian environment.
Table (8) shows that there is a significant statistical relationship between sector of the firm and the techniques used. The significant level of (0.028) is lower that (0.05). This implies that the hypothesis (Ho) is substantiated. The results show that the highest attitude was for manufacturing as the mean is 3.44 followed by wholesale and retail trade with mean 2.79.

Insert Table 8 about here

Discussion and conclusion

Jordan is considered a small country that justifies the low capital of 44.3% of the enterprises of the sample. Only 20% of the enterprises have capital ranging from 5-10JD millions and 8.6% with capital more than 10JD millions. The small capital of firms justify the small annual sales which reached less than 9JD million for more than half of the enterprises of the sample.

The results showed that the exchange rate risk affects in the first rank the sales and revenues, and in the second rank the profit which the least effect is on the cost. The majority of sample showed that they deal with USA Dollar followed by the Euro which is considered the most frequency foreign currencies used by different enterprises.

The results showed that there is no significant difference for the effect of firm size on transactions management.

Also, there is no significant difference for the effect of sales volume on transaction risk management in different enterprises. The results showed that the firm activity affect the transactions risk management. The highest management was found in the manufacturing sector as this sector is highly affected by exports that affect revenues and imports of raw material that affect cost.

In conclusion, the results showed that the high constraint that affects the transaction risk management in enterprises is related to the activity of the enterprise.

References

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Sedik, TS, Petri, M, (2006). The Jordanian Stock Market- Should you invest in it for risk diversification or performance?, IMF Working Papers 06/187, International Monetary Fund.

Table (1) Frequency and percentage of Firm's Capital

	Frequency	Valid Percent
<1 m	31	44.3
1-5 m	19	27.1
5-10 m	14	20.0
10m or more	6	8.6
Total	70	100.0

Table (2)Frequency and percentage of annual sales of the firms (m: millions)

	Frequency	Valid Percent
<3 m	20	29.9
3-6m	25	37.3
6-9m	10	14.9
9-12m	6	9.0
13-15m	2	3.0
15 m or more	4	6.0
Total	67	100.0

Table 3: The effect of exchange rate variations on the firms' activities

Activity	Mean	Sd
Sales and revenues	3.35	1.28
Cost	2.67	1.39
Profit	2.81	1.39

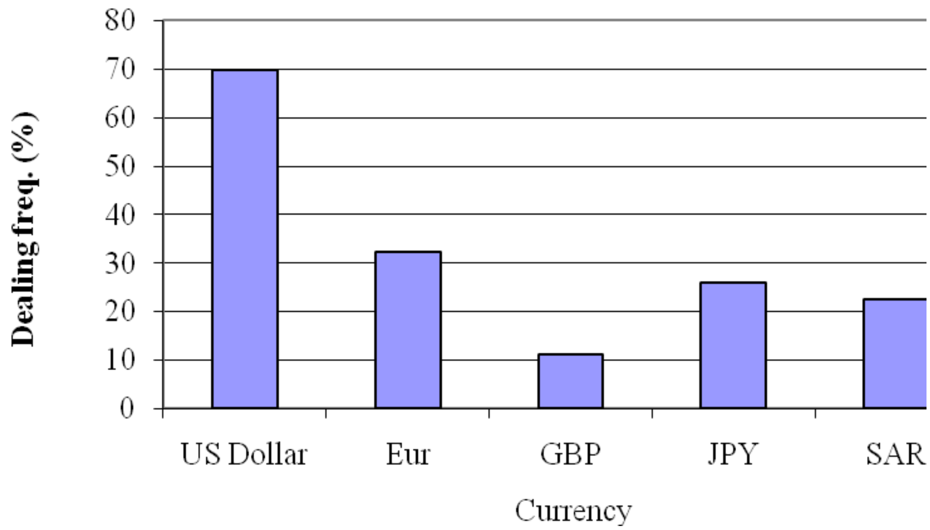

Figure 1: Frequency dealing with foreign currencies according to type of currency

Table (4) the effect of capital size on managing transaction exposure risk

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
<1 m	13	2.5618	1.25761	.34880	1.8018	3.3217	1.00	4.33
1-5 m	9	3.3888	.64716	.21572	2.8914	3.8863	2.27	4.40
5-10 m	11	3.4977	.71636	.21599	3.0165	3.9790	2.40	5.00
10m or more	3	3.6869	1.17689	.67948	.7633	6.6104	2.73	5.00
Total	36	3.1483	1.03424	.17237	2.7983	3.4982	1.00	5.00

Table 5: Analysis of variance for the effect firm size on the techniques used to manage transactions

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	7.206	3	2.402	2.543	.074
Within Groups	30.231	32	.945		
Total	37.438	35			

Table (6) the effect of sales volume on managing transaction exposure risk

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
<3 m	8	2.3523	1.62872	.57584	.9906	3.7139	1.00	5.00
3-6m	15	3.1988	.70348	.18164	2.8092	3.5884	2.00	4.40
6-9m	6	3.6015	.43486	.17753	3.1452	4.0579	3.00	4.00
9-12m	4	3.5476	.55737	.27868	2.6607	4.4345	2.86	4.00
13-15m	2	3.3667	1.36707	.96667	-8.9160	15.6493	2.40	4.33
15 m or more	4	3.4318	1.06374	.53187	1.7392	5.1245	2.73	5.00
Total	39	3.1554	1.02638	.16435	2.8227	3.4881	1.00	5.00

Table 7: Analysis of variance for the effect of sales volume on transaction exposure risk management

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	7.393	5	1.479	1.495	.218
Within Groups	32.639	33	.989		
Total	40.031	38			

Table (8) the effect of firm's sector on transaction exposure risk

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Minimum	Maximum
					Lower Bound	Upper Bound		
Manufacturing	18	3.4440	.74343	.17523	3.0743	3.8137	2.00	5.00
Wholesale and Retail Trade	19	2.7931	1.13568	.26054	2.2457	3.3405	1.00	4.40
Others	1	5.0000	.	.	.	.	5.00	5.00
Total	38	3.1595	1.03984	.16868	2.8177	3.5013	1.00	5.00

Table 9: Analysis of variance for the effect of firm activity on transaction exposure risk management

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	7.395	2	3.697	3.968	.028
Within Groups	32.612	35	.932		
Total	40.007	37			