

CHAPTER 2

JORDAN OVERVIEW

2.1 Introduction

Jordan is a small Arab country with a population of seven million. The Jordanian government depends on foreign grants to cover its budget deficits. On 25 October 2001, His Majesty King Abdallah II instructed the government of Jordan to develop an integrated economic program to accelerate the pace of economic reforms, increase the quality and standard of living of Jordanians, and decrease the country's dependence on foreign grants. The government launched the economic transformation program on 15 November 2001. This program aims to simulate the role of private sectors in the economy through increased collaboration between the public and private sectors, introducing appropriate legal and institutional framework to increase investments in the economy (Haija, 2012). Because of the problems in the neighboring countries, the Jordanian economy and budget deficits have declined and worsened. These have negatively affected the Jordanian economy and firm performance in the public and private sectors, as well as the performance of companies on the Amman Stock Exchange.

This chapter presents the overview of Jordanian economic and Amman Stock Exchange. The Amman Stock Exchange indices have also been detailed. Lastly, the chapter highlights the current issues in ASE.

2.2 The Jordanian Economy

Jordan has an emerging market economy. The economy has grown at an average rate of 8 percent between 1999 and 2008, but growth has slowed down to 2 percent after the Arab Spring in 2011. Substantial population growth, coupled with stagnating economic growth and rising public debt, has worsened the incidence of poverty and unemployment in the country. The main obstacles to Jordan's economy are scarce water supplies, complete reliance on oil imports for energy, and regional instability. In the last few years, its economic growth has stagnated, averaging around 2 percent. Jordan's total foreign debt in 2011 was \$19 billion, representing 60 percent of its GDP. In 2016, the debt reached \$35.1 billion, or 93.4 percent of its GDP. The influx of Syrian refugees has increased competition for jobs, slowing wage growth. The downturn, which began in 2011, continued until 2018. Five sectors with the most contribution to GDP, i.e., government services, finance, manufacturing, transport, and tourism and hospitality, have been badly impacted by the Syrian civil war (World Bank, 2019).

The substantial debt growth is attributed to regional instability and a general weakness in performance. These are also the reasons for the lack of investment in companies listed on the Amman Stock Exchange (ASE). This can be seen from the significant decline in trading volumes over the past years. This issue will be further explained in the background of the problem. The current study estimated the performance of firms listed on the Amman Stock Exchange by examining their internal and external factors. In this case, external factors relate to the prices and returns of the firms' stock in the market. To provide some context, the Amman Stock Exchange is discussed in the following sections.

2.3 The Amman Stock Exchange (ASE)

The Amman Stock Exchange (ASE) is an emerging financial market in the Middle East and North Africa (MENA). It was established in March 1999 as a non-profit independent institution that functioned as a regulated securities market. Subsequent to its registration as a state-owned public shareholding company on 20 February 2017, ASE changed its name to The Amman Stock Exchange Company. The Company, governed by a seven-member board of directors, is then considered as the successor to ASE, legally and factually (ASE).

The ASE Company is responsible for the operation, management, and development of ASE market activities. It aims to provide a strong secure environment of supply and demand forces to support fair trading practices. The company also aims to raise awareness and knowledge of investments and the services that it provides. To achieve its goals, the ASE Company has introduced a set of internal rules and regulations, borrowing from best international practices, to govern its management.

Other activities of ASE Company include computing market indices and signing strategic commercial investments and partnerships in Jordan. “Furthermore, it cooperates and exchanges information with other financial markets, regulators, government authorities, and non-governmental institutions. It also participates in regional and international agreements to increase its regional and global market share.

The ASE Company consists of three main sectors: financial, industrial, and services. The financial sector includes banks, financial services, real estate, and insurance. The industrial sector covers the manufacturing, food, paper, leather, and other industries. The services sector comprises all commercial services, communications, transportation, and others. These classifications are made according to the principal activities of the listed companies (ASE; Haija, 2012).

2.4 Amman Stock Exchange Indices

ASE computes indices to pattern the movements of stock price and measure market returns. In 1980, the Amman Financial Market (AFM) developed the Unweighted Price Index, which was supplemented by four sub-indices: Banking and Finance Companies, Insurance, Services, and Industrial. The Index incorporated 38 stocks and was given a base value of 100 on the opening market session of 1 January 1980. From 1 January 2004, the base was increased to 1,000. Based on the outcome of an extensive statistical study, AFM began developing the Market Capitalisation Weighted Price Index in 1992, which covered 50 stocks. Over the years, the number of its constituents would be growing: 60 in 1994, 70 in 2001, and 100 in 2007.

Additionally, ASE also constructed a free-float-shares-based index, which provides reduces bias towards large-cap firms, thus offering a more accurate measure of share price movement. Instead of total outstanding shares, the ASE computes the index using the market value of free float shares. This method has been notably applied by leading stock market index providers, such as Standard & Poor's, FTSE Group, Dow Jones, and STOXX, in many global markets. The ASE Company followed Dow Jones and STOXX's methodology to select the index's constituents. The index covers all companies that are sited in Jordan and listed primarily on the Amman Stock Exchange. Companies in the bottom 1 percent by full market capitalisation and firms that do not trade more than 33.33 percent of all trading days per quarter are excluded. The remaining largest 100 companies by full market capitalisation are included in the index. To prevent the index from being dominated by individual securities, the weights of individual stocks are capped at 10%. The base value of the index is 1,000.

ASE indices are computed using the latest daily closing prices. Index constituents are selected based on their market capitalisation and number of traded days. In addition,

the indices are continually adjusted to maintain their stability, to safeguard them from exceptional events, and to perfectly mirror market trends. The indices that are calculated by weighted free float market capitalisation are: Market Indices (First and Second Markets), General Index ASE100, and ASE20 Index. These indices are reviewed and adjusted quarterly, but non-periodic adjustments can be made for stocks whose trading will be halted for an extended period or permanently (ASE).

2.5 The Performance Review in ASE

Previous studies have examined in-depth the performance variables of ASE-listed firms. Variables of management performance include strategic planning, investment decisions, and mergers and acquisitions. Variables of human resources performance include wages, employee loyalty, investment in training, and HR practices. Variables of supply chain performance include product marketing, manufacturing, and logistics services. Some studies have examined the impact of intellectual capital variables on the financial and administrative performance of ASE-listed companies. Other studies have estimated the effects of technology variables, such as ICT, databases, systems capabilities, and websites, on the companies' performance. Past studies have also investigated how corporate governance variables predict changes in ownership structure, compensation, and incentives for managers and executives of ASE-listed companies. Board characteristics, e.g., independence, quality, board structure, number of meetings, and demographics, have also been used to estimate the companies' performance. The Altman Z-score model has also been tested in various ASE sectors. In addition, some studies investigated the impact of financial ratios, accounting indicators, valuation indicators, profitability indicators, and credit risk indicators on firm performance, proxied by stock price and return. All the above mentioned studies

assessed firm performance. The current study focused on the effects of three main variables on firm performance: variables related to firm characteristics, variables related to firm's operational activities, and variables related to stock prices and returns. Precisely, it investigated firm performance using accounting and market indicators; determined which indicators can distinguish between performing and underperforming companies; and examined the mediating role of stock volatility on the relationships between accounting and market indicators and firm performance. Previous studies highlighted these explanatory variables in many aspects. Wijaya (2015) analyzed the influence of financial ratios on stock returns. The results revealed that return on assets, debt to equity, dividend yield, earnings yield, and book-to-market ratio have significant effects on stock returns. Duffee (1994) observed that a firm's stock return volatility rises after its stock prices fall. Gonta and Yang (2013) examined the relationships between price multiples and stock price volatility. Price-to-earnings ratio and price-to-book ratio were employed. The findings showed that the correlation coefficients vary across industries and over time in both strength and direction. The results suggest that price-to-earnings ratio and price-to-book ratio can be used to build a predictive model for stock price volatility. The study clarified that the model is best suited during financial crises or economic downturns.

In Jordan, Al-manaseer & Al-oShaibat (2018) investigated the validity of the Altman Z-score model to predict financial failure in insurance companies listed on the ASE in 2011-2016. The study revealed that the high predictive power of the Z-score model could assist users of financial statements to make rational decisions in the face of financial distress. Recently, Qasim (2020) examined the performance trend and predicted bankruptcy of three Islamic banks from 2010 to 2016 using the Altman Z-score model. It also presented the Z-score model as a beneficial diagnostic technique

for possible causes behind weak bank performance. The current study follows up past research on stock prices and returns. It differs from past studies in two aspects. First, it distinguished between performing and underperforming companies using a unique discriminant method. Second, it examined the mediating effect of stock volatility on the relationships between accounting and market indicators and firm performance. The results can assist investors to choose appropriate investment opportunities and make rational financial decisions.

2.6 Amman Stock Exchange Current Issues

Since its inception, the number of companies listed on ASE has reached 270 since its inception. The Jordanian economy faces many political and economic crises due to the refuge of the displaced from neighbouring countries. This has led to an increase in economic burdens and a decrease in GDP. These produce negative consequences to many companies and factories, causing their closure or withdrawal from the market. The pessimistic economic conditions have caused a significant decline in the number of ASE-listed companies; by early 2020, only 190 companies remain listed.

Over the past decade, the performance of ASE-listed companies have significantly weakened. Share trading activities have significantly declined, while numerous companies have been liquidated due to bankruptcy. Investors appear to be less able to find desired investments under these critical conditions. While ASE provides a range of information and indicators to help investors make investment decisions, they appear to not meet investors' needs amidst the prevailing uncertainties, fluctuations, and declining share prices. Testing the effects in a new context that accounts for the impact of those fluctuations and utilises the available indicators may help investors to choose their desired investments.

2.7 Conclusion

The main objective of this chapter is to present overview of Jordanian economic and Amman Stock Exchange. Some of current issues in ASE have also been presented. The next chapter will present the theories and literature review of the study.

