Chapter 59

General Outlook on Financial Structure and Capital Adequacy of ISE-30 Companies during Economic Crisis (2008-2009)

Deniz Umut Erhan
Baskent University, Turkey

M. Uğur Akdoğan
YMM, Turkey

ABSTRACT

In the simplest terms, economic crises could be recognised as abnormal fluctuations adversely impacting market conditions. Despite subsequent economic recoveries, markets and the financial system remain in a period of significant uncertainty after such crises. The baseline scenario is for balance sheets to strengthen gradually as the economy recovers and as progress is made in addressing structural problems in financial positions. However, substantial downside risks always remain for companies. Even companies with a high "Capital Adequacy Ratio" (CAR) face the difficult challenge of managing a smooth transition to self-sustaining growth while stabilising debt burdens under low and uncertain economic prospects. Without further bolstering of balances sheets, markets remain susceptible to funding shocks that could intensify deleveraging pressures and place further drag on public finances and recovery. Companies have proven resilient to economic turbulence but are vulnerable to a slowdown and face risks in managing sizable and potentially volatile capital inflows. Policy actions need to be intensified to contain risks, address debt burdens, and implement effective and institutional frameworks to ensure financial stability. Based on this perspective and through applying the financial soundness indicators methodology, the financial structures and soundness indicators of the top 30 companies on the Istanbul Stock Exchange (ISE-30) are subjected to an assessment for determining the impact of the global crisis. The short- and long-run credits and non-monetary debit lines of ISE-30 companies are investigated together with the momentum of growth in assets, liabilities, and cash-flow stabilities. The financial soundness of ISE-30 companies is discussed in terms of the "capital-liabilities ratios" performance measure. Finally, the study focuses on long-run economic impacts and the analysis assumes that companies should transition to new levels of capital and liquidity to strengthen their financial stability and sustainability.

DOI: 10.4018/978-1-4666-4707-7.ch059

INTRODUCTION

Market economies require robust and competitive financial systems, national and international, to intermediate between those with financial resources and those with productive and innovative uses for said resources. That intermediation necessarily poses risks – risk with respect to bridging maturity preferences of savers and borrowers and risk with respect to creditworthiness. The process, to be effective, depends on mutual trust – trust based on confidence in the integrity of institutions and the continuity of markets. That confidence, taken for granted in well-functioning financial systems, was lost in the 2008-2009 financial crises, in substantial part due to the recent increase of complexity and opacity in the global economy.

The costs and economic implications of the 2008-2009 global crisis cannot be fully known currently, but we know they are severe, whether measured in trillions of dollars, in the length and depth of the worldwide recession, in the collapse of national economies or in simple human terms of unemployment and shattered personal finances. We also know that there is a need for comprehensive reform to address the major institutional, market, regulatory, policy, and infrastructure weaknesses that have been exposed.

These weaknesses include weak credit appraisal and underwriting standards; extreme and sometimes unrealised credit concentrations; misjudged maturity mismatches; wildly excessive use of leverage on and off balance sheets, often imbedded in little-understood financial products; and unwarranted and unsustainable confidence in uninterrupted market liquidity. Gaps in regulatory oversight, accounting and risk management practices that exaggerated cycles, a flawed system of credit ratings, and weakness in governance also need attention. As reported in a financial reform framework report (Group of Thirty, 2009), to some degree these factors have been evident in other, less damaging periods of financial crises. Two unique features have worked together to help account for the extent of the current market breakdown. Highly aggressive and unbalanced compensation practices have strongly encouraged taking risk over upholding prudence. At the same time, the complexity of highly engineered financial instruments obscured the risk and uncertainties inherent in those instruments, giving rise to false confidence and heavy use of leverage to enhance profits as asset prices rose. As those asset prices began declining, the risks became apparent and triggered asset sales. A downward spiral of deleveraging undermined the stability of even the largest financial institutions at the core of the system, contributing to an economic contraction of global proportions. Authorities in most countries have been stretched to and even beyond the limits of their capacity to restore liquidity and contain the instability.

The global crisis, which erupted in developed markets and then spread across the world during the last quarter of 2008, has continued to affect the economic outlook, albeit less forcefully since the third quarter of 2009. In that period, data releases on financial systems and global economic activity indicated that the global economy had started to recover on the back of fiscal measures implemented by public authorities during the crisis. However, improvements in many leading indicators were still slow and unstable, denoting that the recovery would likely be gradual. This recovery trend in the economy bolstered the improvement that started in the financial markets in the second quarter of 2009. Indeed, the bottleneck in the dysfunctional interbank markets due to counterparty exposure had been remedied significantly, as indicated by LIBOR-OIS and TED spreads (Central Bank of the Republic of Turkey, 2009).

There have been significant improvements in financial asset prices globally on the back of funds provided to markets by central banks. As a matter of fact, following improvements in balance sheets of banks from developed countries due to government support and capital injections, the rise in stock markets, primarily in banking shares, continues

Related Content