



Impacts of Financial Systems In the Development of an Economy on Companies Listed in Tadawul

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Abstract

There is a positive relationship between financial systems and economic growth. This is true because financial systems include financial markets, institutions, and players who collaborate in swift unison to ensure that financial funds are channeled from lenders to borrowers. Beck, Degryse, and Kneer (2014) argue that there are companies that operate in economies, and which require financial resources to meet unexpected rise in demand for goods/services. Financial systems ensure that the saved funds are availed to these companies so that they could finance the respective contracts/tenders and realize profits. This paper aims to conduct an empirical analysis of the relationship between financial systems and economic growth and development. It will use a case study approach to evaluate how companies listed in Tawadul's stock market receive funds from financial institution and banks to finance their operations, thus ensure business continuity. The methodology used is quantitative analysis which comes in handy in collecting numerical data from the balance sheets of these companies and interpreting them by looking at the trends of the inventory level, current assets, liabilities, shareholders' equity, and others, in the last ten years.

Key Words: economic growth and development, Tawadul, financial systems, monetary resources, balance sheet.



Introduction

A proper management of funds in an economy is a prerequisite condition for the economic growth of any country. Effective circulation and use of financial resources leads to the industrial growth and development of any country. When the funds are not circulated effectively in a given economy, then they will be frizzed, thereby commanding a negative impact in the economic development initiative of any state. In the long-run, there will be an obstacle in the growth and establishment of industries. There is a positive relationship between financial systems and economic growth. For an economy to perform to its full potential, it is important for the financial system to be active and robust. The financial system majorly comprises of banks that act as central entity alongside other providers of financial services. A country's financial system is deeply inculcated in the respective society and is a source of employment for a substantial number of citizens. The goal of this paper is to analyze management of the financial sector on the growth and development of the economy based on the companies listed in Tadawul.

The approach used includes quantitative analysis that is able to inform a series of robust outcomes. The following empirical hypotheses are examined H_1 the correlation between the development of the financial sector and economic growth as a non-linear relationship; H_2 an extremely large size of the financial sector does directly insinuates more rapid growth and development of the economy. The paper will make use of the companies that are listed in Tadawul to explore the nature of relationship between financial systems and economic growth and development of Saudi Arabia. Companies listed in Tadawul create a platform for effective



circulation and utilization of funds in the economy of Saudi Arabia, thereby informing economic growth and development.

Literature/Theoretical Underpinning

Financial systems are a term that captures the interconnected and complex components that comprise of both non-specialized and specialized financial institutions, unorganized and organized financial markets, financial services, and financial instruments. The underlying goal of the financial system includes the facilitating the circulation of financial resources in a given economy. It is concerned with credit, money, and finance (Hart & Spero, 2013). Money refers to the payment mode or exchange medium. Credit describes the level of debt which is repaid alongside some predetermined interest. Lastly, finance is defined as the monetary resources that comprise of ownership debts and funds of the company, state, or individual. Consequently, financial systems refers to the integrated form of financial markets, financial institutions, financial securities, and financial services that aim to circulate funds in a given economy with the intention of commanding economic growth.

The financial system is directly proportional to a country's rate of economic growth and development. According to Aizenman, Jinjark, and Park (2013), there are three main roles of a financial system. The first function is credit provision, whereby governments invest in projects, such as infrastructure through the reduction of the cycle of tax incomes and correcting spends. Businesses could invest more funds than the financial resources at their disposal, and people could purchase properties without having to save the whole amount in advance. Secondly,



provision of liquidity. In this case, banks and other financial dealers protect individuals and businesses against unexpected cash needs. Banks are able to offer the facility of deposit demands which the individuals or businesses can withdraw. In the same fashion, they offer overdraft and credit facilities to companies. In addition, financial institutions and banks offer to sell or buy securities depending on the need of the financial needs of the companies. They carry out such transactions in large volumes that are sufficient to fulfill the sudden financial requirements of the stakeholders. Lastly, there is the service of risk management, whereby finance offers risk management from the risks associated with financial markets and prices of commodities through pooling risks together (Minsky, 2016). There are derivative transactions that make it possible for banks to extend this service of risk management. Such services are highly valuable despite the fact that they receive some flak because of excesses in the course of financial crises.

Methodology

This paper adopted an empirical approach to collect data and determine the possible ways that they were consistent with the two hypotheses statements. H_1 sought to determine how financial systems inform economic growth whereas H_2 was interested in proving that the larger the financial system of a country, the more rapid its economic growth because of the presence of relatively more companies. Quantitative analysis was used to explore the balance sheets of the various companies listed in Tadawul, and thereafter interpret the data by looking at the trends in the last ten years.



Results/Findings

From the previous discussions, it is apparent that financial systems are influential in channeling funds to companies so that they could have the financial resources to carry out their corporate operations without interruptions. The companies in Tadawul make use of financial systems to secure money from investors and financial institution reserves, and thereafter inform their investment initiatives. For instance, in responding to an impromptu supplying contract, a company, such as Saudi Pharmaceuticals Industries and Medical Appliances Corporation will apply for funds in the financial markets in the form of a loan or proceeds from the sale of its shares. The accumulated money will be used to finance the needs and requirements of the tender contract. This is what is regarded as the company's financial system since it has linked lenders to the firm (which is the borrower in this case) (Van den Berg, 2016). Consequently, the financial system of Saudi Pharmaceuticals Industries and Medical Appliances Corporation includes the procedures that are implemented and which are instrumental in tracking the firm's financial activities. There are multiple elements that form the financial system at varied levels: in the context of a corporate entity, the financial system encompasses all tenets of finances. With respect to this analysis, the financial system comprises of the wages, expense schedules, verification of the balance sheets, and sundry.

A company's balance sheet is a good threshold for determining the financial depth of a company; thus the effectiveness of the respective financial system. For instance, a look at the balance sheets of the companies that are listed in Tadawul aid to demonstrate whether Saudi



Arabia's financial system is inversely proportional or directly proportional to its economic growth. In other words, consistencies in the cash flows of Saudi Research and Marketing Group reveal that the national government is keen to ensure that the financial system serves the growth and development agenda of the listed companies. In the last decades, monetary economists have strove to consider how the balance sheets reflect the nature and quality of monetary policies (Friedman, 2017). This is because financial systems specialize in channeling saved funds towards productive, profitable investments by the companies listed in Tadawul. This means that a growing balance sheet suggests that the respective financial system is performing as per the expectations of the various stakeholders. In looking at the current assets of Abdullah Al Othaim Markets Company for ten financial years, one could notice the irregular shape of the graph. In 2017, the value of the company's current assets was recorded at 428, 158, in 2016-588, 029, 2015-596,766, 2015- 320, 637, 2013- 200, 636, in 2012- 143, 364, in 2011- 149, 084, in 2010- 126, 914, in 2009-197, 260, and in 2008-166, 324. The same trend could be observed in the current asset graph of Saudi Airlines Catering Company for the last nine years. In 2009, the current assets was recorded at 742, 622, in 2010 at 1, 140, 856, in 2011 at 1, 314, 693. In 2012, It was recorded at 1, 393, 446, in 2013 1, 374, 112, in 2014 1, 393, 446, in 2015 at 1, 374, 112, in 2016 1, 380, 896, and lastly in 2012, it was recorded at 1, 192, 983. This is an upward trend and it suggests the effectiveness of the financial system in extending lending and borrowing initiatives in the Saudi Arabia economy.

Inventory is also an important provision that could be used to determine the degree of financial investments that is channeled to companies from the financial markets in a certain



financial system. A look at the inventory trend of Saudi Airlines Catering Company reveals a regular trend generally. In 2012, the inventory was recorded at 73, 280, and in 2013- 76, 630. In 2014, it was at 73, 280, and in 2015- 76, 630, in 2016 86, 753, and in 2017 142, 376. This is an upward direction in general terms, except for the financial year 2014, where there was a negligible decline before the trend assumed the initial growing pattern. The shareholders equity could be a representation of the sales level, since the shareholders receive their dividends based on the money that is generated through the sales level (Rousseau & Wachtel, 2011). This means that a higher sales level translates into greater shareholder equity at the end of the financial year.

The shareholder equity of Saudi Printing and Packaging Company for the financial year 2009 was recorded at 765, 115. In 2010, it was 749. 758, in 2011- 754, 659, in 2012- 847, 568, in 2013- 866, 219, in 2014 847, 568, in 2015 it was recorded at 866, 219, in 2016 911, 735, and lastly, in 2017, it was recorded at 933, 594. The returns that the shareholders received grew regularly in the nine financial years that the company operated in Tadawul.

Discussion

Current assets refer to the cash and other forms of assets that a company is able to liquidate within a span of one year. Examples include prepaid expenses, accounts receivable, and other forms of negotiated securities. They are presented on the balance sheet and feature as a way of empirically determining the liquidity of a company. A stable and high growth rate of current assets is an obvious desired result. Looking at the historical growth rate of a company's current asset is a sure way of determining a company's stability; thus the effectiveness of the



respective financial system. the current assets of Abdullah Al Othaim Markets Company has been on a consistent rise in the last ten years, meaning that the past growth rate signifies good tidings with respect to future growth rate (Law & Singh, 2014). This is a straightforward evidence to suggest that the government of Saudi Arabia is up to the task when it comes to developing the financial system that offers sufficient support to the country's economy. Consequently, the country's financial system is active when it comes to informing economic growth and development.

A look at the trends of inventory of some of the companies listed in Tadawul helps to demonstrate the nature of Saudi Arabia's financial system with respect to the performance of the respective economy. Inventory refers to the collection of items, such as stocked goods, property, or the contents in a building. A company's inventory level rises when the production of goods exceeds the sales and declines when sales surpass production. This means that an inventory level that is high affects the cash flows negatively, including the warehousing capacity. On the other hand, sharp declines in the level of sales could inform obsolete inventory, thereby it becomes critical to strike a form of balance between inventory and production rates with respect to the volumes of sales. This means that an active financial system is able to channel the needed funds that companies utilize in financing the production of goods-thus when there are excess funds in the financial markets available for a manufacturing firm, and then it will make goods that will lead to a greater inventory level relative to the capacity of sales. From the results section, the inventory level of Saudi Airlines Catering Company assumed a general upward trend, and this means that the level of financial resources that were availed to the company from Saudi Arabia's



financial system increased in the last six financial years. This is a demonstration of the impact of the country's financial system in initiating growth and development of the companies, and the economy of the country at large.

The shareholders' equity of Saudi Printing and Packaging Company assumed an increasing trend in the ten financial years. This value (shareholders' equity) could be used to gauge the sales performance of the company. This is because the funds that are availed to the shareholders are a representation of the sales efforts and level that the firm realized at the end of the financial year. This is a representation of corporate growth-since Saudi Printing and Packaging Company realized more prints and packaged more goods than the previous financial year, suggesting a sense of corporate growth in the sales capacity)and prosperity (Reinhart & Rogoff, 2010). This means that the respective financial institutions and banks in the country were more than willing to extend financial assistance to the company so that it could undertake its operations with business continuity and limited interruptions. For instance, when Saudi Printing and Packaging Company received an order to print books and package them, the management was not worried about where they will secure financial resources to purchase capital goods and meet the underlying operating expenditure. This is despite lacking liquid money that was readily available to finance this transaction.

Implication to Research and Practice

The findings realized by this paper have significant implications to both research and practice. The paper has set the trend for researchers to conduct in-depth analyses of the



relationship of the various provisions of the balance sheet and the performance of the stock market. In other words, how do current assets, liabilities, inventory, fixed assets, and others reflect the effectiveness of the financial markets in channeling monetary support to companies (Nelson, 2013). In practice, the findings in this paper will ensure that financial analysts and experts empirically determine how and to what extent companies listed in the stock market contribute to economic growth and development.

Conclusion

Finally, companies listed in Tadawul create a platform for effective circulation and utilization of funds in the economy of Saudi Arabia, thereby informing economic growth and development. This paper has satisfied its underlying goal of demonstrating how the financial system of Tadawul is responsible for channeling investment funds to listed companies, thereby informing long-term growth and development of Saudi Arabia economy. A financial system could refer to the initiative that is undertaken by banks and other financial institutions in the course of protecting companies against unexpected cash needs. A company's balance sheet is a good threshold for determining the financial depth of a company; thus the effectiveness of the respective financial system. A look at elements, such as the trend of inventory, shareholder's equity, current assets, and others aid to reveal the effectiveness of financial systems in availing financial resources to companies so that they could have a sense of continuity in their business operations.



Future Research

This paper sought to undertake an empirical research on the role of financial systems in commanding economic growth and development. The findings reveal that indeed companies benefit significantly from the function that financial systems undertake in ensuring that financial resources are available for companies to meet their production needs. Having satisfied the overall objective, this paper recommends further investigation into the impact of having excess financial resources circulating in the economy/financial systems. In other words, what is the effect of companies that are listed in Tadawul receiving more funds than what they need to finance their production projects. It is imperative to evaluate whether excess funds would lead to larger inventory levels that would increase inventory management costs and lead to losses when some of the stored goods are damaged, expire, or succumb to other negative outcomes.



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