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Table Of Content

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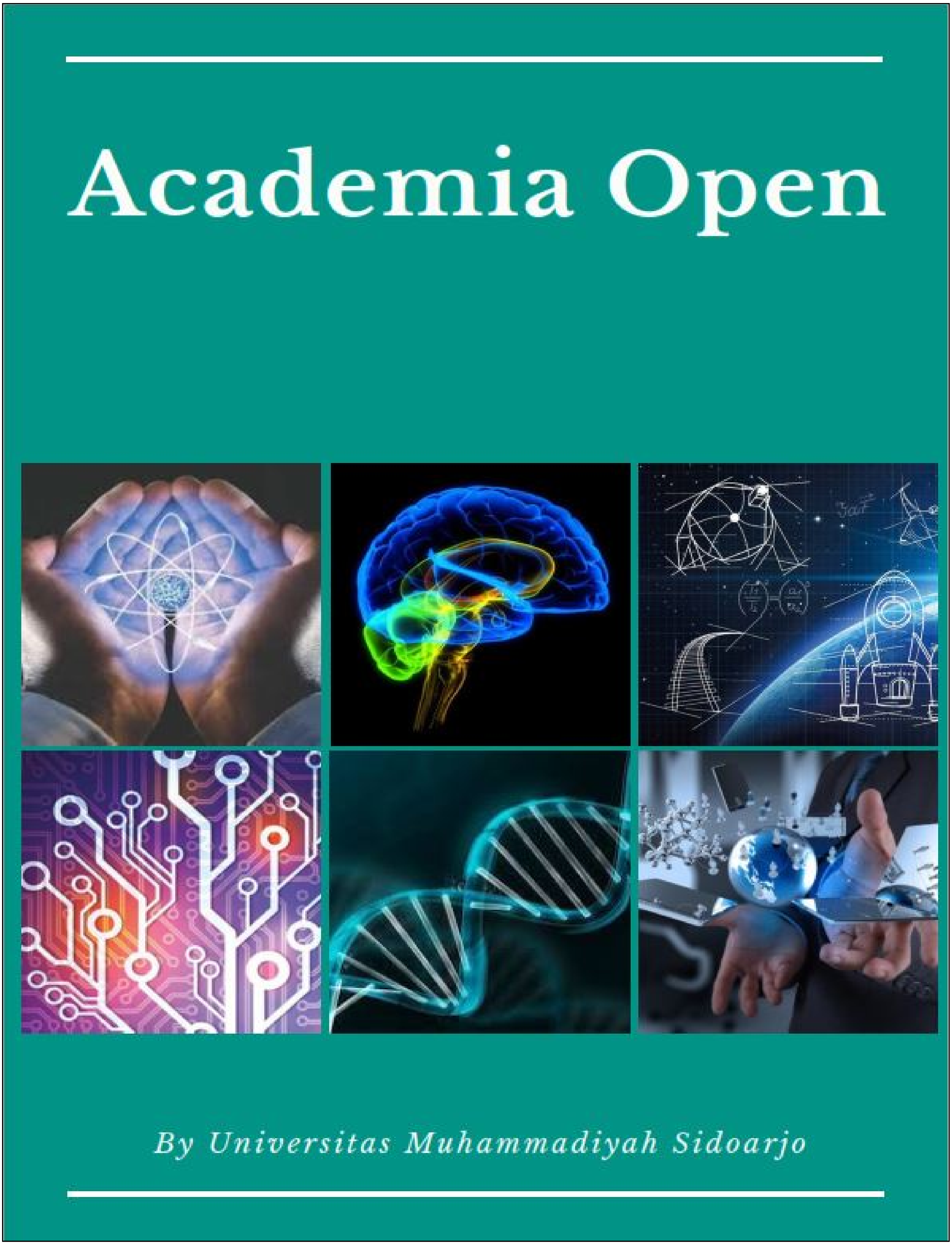

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Highlighting the Urgent Need for Reforms in the Face of Financial Failures at State-Owned Enterprises in Iraq

Menyoroti Kebutuhan Mendesak untuk Reformasi dalam Menghadapi Kegagalan Keuangan pada Perusahaan Milik Negara di Irak

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Abstract

General Background: The financial analysis of companies' reports is critical for assessing their past performance, forecasting future results, and identifying operational strengths and weaknesses. **Specific Background:** Financial failure, which occurs when a company cannot generate adequate returns to cover costs and capital expenses, poses significant risks to stakeholders. For state-owned companies, the implications of financial failure are especially profound, given their integral role in national economies, such as Iraq's. **Knowledge Gap:** There is limited understanding of the extent to which state-owned companies in Iraq utilize financial analysis to predict financial failure, particularly in the context of economic transitions and privatization pressures. **Aims:** This study aims to evaluate the dependence of Iraqi state-owned companies on financial analysis as a predictive tool for financial distress and to identify the key factors contributing to their financial failures. **Results:** The research reveals that 42% of the companies examined have experienced financial failure, as measured by the Argenti index. Contributing factors include employment challenges, insufficient financing, and the transition from a socialist to a capitalist economy, which has left companies vulnerable to privatization. **Novelty:** The study provides novel insights into how economic transition impacts the financial stability of state-owned companies, highlighting the practical application of the Argenti index in diagnosing financial weaknesses. **Implications:** The findings underscore the urgent need to support state-owned enterprises by revitalizing the industrial sector, improving administrative efficiency, and adopting more systematic financial analysis tools. Additionally, the research recommends creating an accessible information center for investors and creditors, which would enhance transparency and support decision-making. This approach could help mitigate financial distress and attract new investment, ultimately contributing to Iraq’s economic recovery.

Highlights:

1. Financial analysis helps predict failures in state-owned companies.
2. 42% of companies fail, based on the Argenti index.
3. Privatization and economic shifts increase financial risk.

Keywords: Financial analysis, Argenti index, state-owned companies, financial failure, privatization

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Introduction

Financial reports serve as a crucial information resource for decision makers, enabling them to assess organizations' performance and make informed decisions. Strategic decision makers depend on a collection of financial indicators to assess the performance of firms and make choices that result in optimizing their advantages. These measures take the form of accounting information such as net income or the form of Financial ratios that are derived from accounting information such as ratios of liquidity, circulation and others. In addition, the financial reports form a picture that reflects the results of the economic phenomena resulting from the company’s activity over a period of time, thus giving a clear picture of its performance and in a way that can diagnose its strengths and weaknesses.

Despite the importance of corporate financial reports, the traditional methods used in evaluating them have become insufficient to provide decision makers with indicators about the future, which are among the important things, especially in the current period witnessing the bankruptcy and liquidation of many companies in various countries of the world. Of the decisions regarding the dissolution, liquidation or merging of some industrial companies as a result of the inability of these companies to achieve the goals for which they were established, and their inability to develop their products in line with the needs of the market, which made them incur heavy losses for several consecutive years.

Since the process of recurring losses may make these companies threatened by the so-called financial failure, therefore, the importance of studying the contents of the financial reports of these companies has emerged in a scientific manner, which can be achieved through the use of financial analysis, which financial indicators are one of its most important outputs, which are formed with others. One of the tools is an objective basis for evaluating the company's financial performance in the past, and to some extent also helping to predict the direction of its future course.

Study problem:

General industrial companies constitute a mainstay in supporting the economy, but in spite of this, most of these companies still rely on simple methods in conducting the process of analyzing their financial statements in order to show their financial performance, as they are nothing more than abstract financial ratios, and since reliance On those simple methods, it may give misleading results about the financial situation of these companies, especially their future status, which may expose them to financial failure, and we can summarize the research problem by the following question: What is the actual reason behind the failure of state-owned companies in Iraq?

Study Objectives: The main objectives of this study are to use financial analysis to predict financial failure, and accordingly, the objectives center on the following points:

1.Knowing the extent to which state-owned companies rely on financial analysis as a tool for predicting financial failure.

2.Knowing the degree to which state-owned companies benefit from financial analysis to predict the future in all directions.

3.Clarifying the importance of predicting financial failure in making decisions at the internal and external levels for companies.

Methods

The importance of the study: The significance of this research stems from the pressing concern of failure and its anticipation among several stakeholders, such as the management of the company, existing and potential investors, banks, creditors, auditors, and government agencies in general. This is due to the profound consequences it has on the company, the economy, and society. Therefore, it is necessary to develop a method for early detection of the potential for future company failures. From this point of view, the importance of this study lies in showing the extent to which financial analysis is used to predict financial failure in state-owned companies.

Study hypothesis: The research is based on: There are obstacles that affect the ability of state-owned companies to use financial analysis to predict financial failure

Result and Discussion

Financial Analysis:

Financial analysis is a scientific discipline that involves the collection and classification of data and information pertaining to a company's lists. It then performs a thorough and precise study to identify the link and relationship between these elements. For instance, it examines the relationship between current assets, which represent the company's liquidity, and current liabilities, which are short-term obligations. It also investigates the relationship between property funds and long-term obligations, as well as the relationship between revenues and expenses. The results obtained are then interpreted and their causes are explored to identify weaknesses and strengths in the financial position. Therefore, in due course (Shim & Siegel, 2007: 56).

Financial analysis is also defined as a critical study of the company's financial statements after reclassifying them to the appropriate tab for the purposes of analysis, with the help of other necessary data that are not included in those lists, using various methods of analysis, with the purpose of clarifying the reasons for the results that happened, evaluating those results and showing the connections between their elements. different projects, tracing their development over successive financial periods, and making the comparison on a sound basis between similar projects (Wang & Campbell, 2010: 335).

Financial analysis can be defined as studying the financial statements after classifying them and using quantitative methods, with the aim of showing the correlations between its elements and the changes in these elements, the size and impact of these changes, and deriving a set of indicators that help study the company's operational and financial position and evaluate the company's performance as well as providing the necessary information to the parties. beneficiaries in order to make sound management decisions (Chen & Guo, 2011: 915).

The objectives of financial analysis: The objectives of the financial analysis process can be summarized as follows (Velavan, 2011: 61):

1.Know the financial position of the company and judge the revenue capacity of the project.

2.Judging the efficiency of the financial and operational performance of the company and evaluating its ability to pay its debts and obligations in the short and long term.

3.Develop future plans and provisions of internal control, identify weaknesses and propose necessary solutions to address them.

Financial analysis tools: Financial analysis tools are defined as a set of technical means and methods and the various methods used by the financial analyst to reach the evaluation of the various aspects of the company's activity and the strengths and weaknesses in its financial and operational operations, which enable him to make the necessary comparisons and conclusions for the evaluation. (Naiping & Li, 2011: 32).

Financial Failure:

The term failure is inaccurate in terms of presenting the financial situation that the company is exposed to, which expresses its failure. It is a concept that combines the financial and legal concepts of bankruptcy and default in companies. (Djiné, 2011: 432).

And he defined failure: as the inability of In order to ensure that the company's returns are sufficient to offset all expenses, including the cost of capital financing, and to address the management's failure to generate a return on the investor's capital that is proportionate to the anticipated risks of those investments, the author defined economic failure as the company's inability to attain a satisfactory or moderate return on its investments, or when the net capital is negative, and when the book value of the company's liabilities exceeds the book value of its assets. Financial failure is the inability of a corporation to fulfill its financial responsibilities to creditors and settle its outstanding debts. (Martin et al, 2011: 216(.

Reasons for financial failure: The reasons leading to financial failure can be divided into four sections (Balcaen et al, 2011: 952):

1.General economic conditions.

2.Local economic conditions.

3.Lack of employee integrity.

4.Lack of management quality.

Stages of financial failure: In order for the company to reach a state of financial failure, especially that it will pass through several stages, which are as follows: (Brigham & Ehrhardt, 2011: 21)

1.Emergence period: It is undeniable that the company does not undergo sudden or unexpected deterioration. However, management can address certain indicator such as shifts in product demand, persistent rise in indirect costs, obsolescence of production methods, intensified competition, and insufficient credit facilities. And escalating liabilities without sufficient working capital. A common occurrence at this stage is an economic loss, characterized

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by a return on assets that falls below the typical ratios of the organization. It is advisable to identify the problem at this stage, as re-planning at this point is more efficient.

2. Cash deficit: This stage arises when the management becomes aware of a financial failure, typically when the company is unable to fulfill its immediate cash requirements. At this stage, the company's assets exceed its liabilities, but the challenge is in the efficient conversion of those assets into cash. In order to settle the unpaid obligations, which may persist for a number of months, and to alleviate this financial vulnerability, the firm must pursue borrowing adequate funds to fulfill its cash requirements

3.Financial degradation occurs when the organization is unable of acquiring the required money to settle its existing debts. Presently engaged in the process of issuing supplementary shares or bonds. If the flaw is detected promptly and the necessary measures are implemented, most of the facilities that experience this stage are effectively remedied. Facilities that are unable to provide the required treatment within the appropriate timeframe progress to the last step, known as complete bankruptcy.

4.Legal failure stage: Due to the company's current inability to manage the failure, it is necessary to initiate legal processes in order to declare bankruptcy.

5.The bankruptcy stage is the last phase in which a company's inability to pay its obligations leads to the initiation of legal processes, resulting in the declaration of bankruptcy. This stage marks the company's failure.

Types of financial failure: The views of those interested in the phenomenon of failure to identify its types vary, but the consensus indicates that failure has the following types (hong & Xiang, 2011: 14)

1.Economic Failure: It means the case of a bank whose realized returns are unable to cover all costs, including the cost of financing. In other words, it means management’s weakness in achieving a return on investment that is less than the prevailing interest rates in the market or is not commensurate with the expected risks for those investments.

2.Financial Failure: The concept of financial failure varies according to the form of analysis that can be used to determine this. Financial failure may mean a situation in which the bank is not able to pay its short-term obligations, even though its total assets exceed the sum of its liabilities, and it also means the state of bankruptcy it is going through. Expense when its liabilities exceed the value of its assets.

Financial failure prediction models: Financial failure prediction models were presented as follows: (Ayotte et al, 2012:3)

1.Beaver's Model (1966): Beaver relied on financial ratios and included a comparison between the average financial ratios of 79 failed companies and those of 79 non-failed companies in the period between 1954-1964 according to specific criteria, for example, the company's exposure to bankruptcy, default on bonds or Bank withdrawals or non-payment of preferred stock dividend, these companies are from the same sector and have the same size of assets, where Beaver selected 30 financial ratios to analyze and used the unilateral analysis method and analyzed each ratio for 5 consecutive years.

2.In 1974, Altman established his approach by utilizing financial ratios and employing multiple discriminating analysis. By use of his approach, he successfully differentiated between prosperous enterprises and unsuccessful ones within the industrial sectors. The model comprises five integrated financial ratios, which were derived from the construction of the 30 Rate index.

3.Kida model (1981): It is one of the modern models that were used in predicting financial failure, and this model was built on 5 independent variables of financial ratios. (anjum, 2012: 34)

4.Model (Springate, 1978): Use the multiple discriminant analysis method to choose the best four financial ratios, which obtained a percentage of 92.5% for their ability to distinguish between 20 successful companies and 20 companies that declared bankruptcy.

5.Fulmer Model, 1984: Fulmer developed a model to predict the failure of companies through the use of a sample of 60 companies, of which 30 successful companies and 30 unsuccessful companies, using 40 financial ratios and the use of multivariate linear discriminant analysis.

6.Argenti 1976 model: It is called (A-Score), and it combines two methods: financial analysis and risk analysis method. It adopts different criteria to assess the state of the borrowing company that combines financial indicators and qualitative or descriptive indicators. Although it gives more weight to the second indicators, it is also seen in the business world as a tool for anticipating danger rather than a model for predicting financial failure. It is also taken that he focuses on the conditions of the borrowing company only and neglects other factors related to the surrounding environment. (Ghodrati et al, 2012: 57)

In the actual application of the model, each of the other three stages leading to failure is given a relationship that is

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proportional to its relative weight, which is specified in the model as follows: Defects: its relative weight is 43, errors: its relative weight is 45, the symptoms: its relative weight is 12, the total is 100.

The Practical Aspect:

A public corporation is an economically self-financed organizational entity that is entirely owned by the state. It possesses legal identity and functions with financial and administrative freedom, following economic principles. Public corporations are structured based on foundation, management, and liquidation, with standardized financial and administrative regulations and mechanisms to achieve optimal development in work and output, as well as the implementation of economic calculation and investment efficiency principles. An analysis of the efficacy of public money in attaining state objectives and enhancing the performance levels of the national economy, considering the presence of 28 state-owned industrial enterprises. (Iraqi Public Companies Law No. 22 of 1977)

According to Argenti's proposal, the three elements (defects, errors, symptoms) are for a set of detailed indicators, giving it a relative weight to each indicator according to what he found in his study. This means that the more the company reaches that relative weight, the more it is a negative indicator for it and vice versa.

The model can be used on a sample of state-owned enterprises to measure the risk of financial failure:

No	Item	Indicators	Relative Weight	Co. Points
1	Defcts	One person management	10	4
		Combining the position of Chairman of the Board of Directors and General Manager	8	3
		Low efficiency of executive management	6	3
		Low efficiency of financial management	5	2
		A defect in the internal control system	3	1
		Defective accounting and management information systems	3	2
		A defect in the recruitment, promotion and training systems	3	2
		Deterioration in the morale of the workers	3	1
		High employee turnover	2	1
Total			43	19
2	Mistakes	Continuous increase in the volume of indebtedness and high indicators of financial leverage	18	9
		A large and unjustified expansion of the company's activity	15	6
		Entering into large projects that exceed the company's capacity	12	3
Total			45	18
3	Symptoms	Bad financial indicators	5	2

		Excessive creative accounting procedures	4	2
		Frequent change in the accounting policies and the auditor of the company	3	1
Total			12	5
Total Sum			100	42

Table 1. *shows the application of the Argenti model to state-owned enterprises*

From the results above, it is clear that the company failed because it obtained a total of 42%, which requires it to study the aspects in which it obtained high marks, diagnose weaknesses, and try to address them to improve its position if it is able to do so.

When reviewing the reasons, it can be said that the problems of employment, poor funding and the transformation of the Iraqi economy from socialist to capitalist made companies vulnerable to the privatization system.

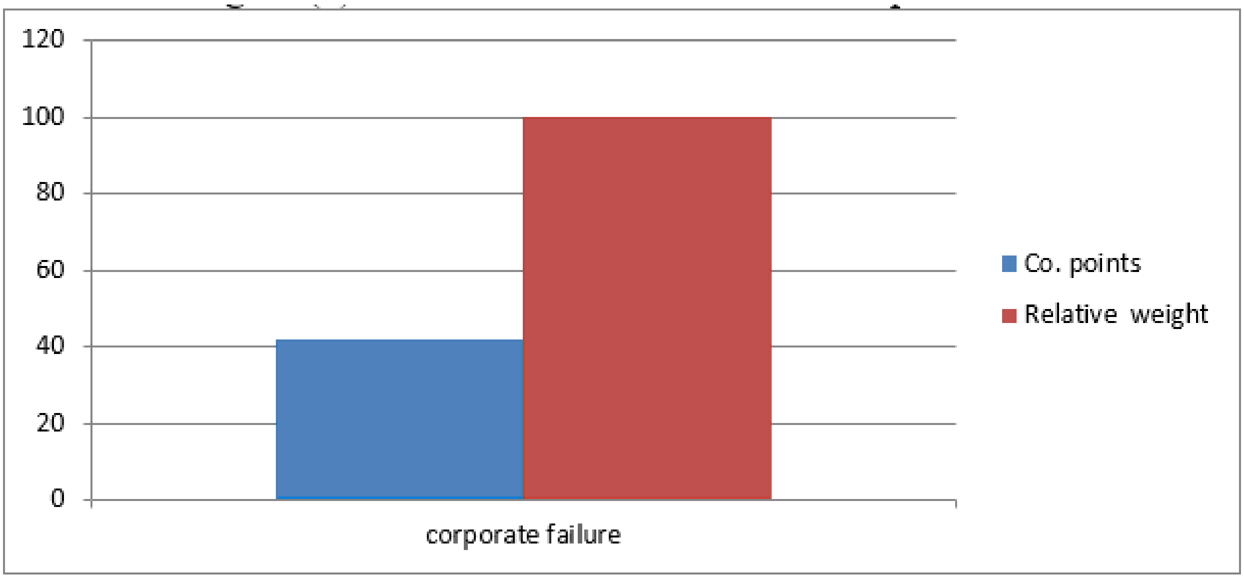

Figure 1. *shows the level of failure of companies*

Conclusion

The state-owned companies are a real tributary to the Iraqi national economy, and therefore their failure mainly affects that, and through the study of the practical side, it is concluded that most companies have been subjected to financial failure by 42% according to the Argenti index. The Iraqi from socialist to capitalist made companies vulnerable to the privatization system.

The research recommends the need to pay attention to state-owned companies by supporting the industrial sector to revive the country's economy and enhance administrative efficiency and to adopt the Argenti index to identify weaknesses and address them before their percentage rises, in addition to creating an information center that is easy to refer to, serving investors and creditors and developing this information continuously for the purpose of attracting investors and financiers new ones.

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