The Importance of Accounting Information to the Investors in Banking sector: Kuwaiti Evidence

By

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Abstract

The financial sector is the biggest sector in Kuwait in term of capital, but unfortunately little research has been done about it. This study tests the information content of accounting data in Kuwaiti banks to the investors in stock exchange market. Six financial ratios are used in this research and also, regression analysis is used to solve the problems that rise in this research.

The research results indicate that accounting information is very useful to investors in Kuwaiti banks, and most ratios are significant except the loss ratio. On other hand, the remaining ratios that return on total assets, net interest margin, earning, burden, yield on earning assets are important for the investor in security market.

This research will provide the link between the accounting information and market information to the users in clear way. This research will provide some insight in accounting in financial sector when the financial statements are prepared according to international accounting standard.
1. Introduction

The financial industry in Kuwait is very important due to their critical role in the economy. This study will focus in banking sector, there are six commercial banks in Kuwait also there is also Kuwait Finance House and two specialized banks for industrial and real estate. Finally, Kuwait Central Bank is the government bank which organize the banks functions in Kuwait.

The purpose of this paper is examine the accounting information to the investors in security market using selected ratios. This study will help investors to identify the important number for the security market.

The banking sector has different financial statements than other industries in term of the nature of accounts, this study calculate different ratios relate to the banks.

2. Kuwaiti Banks

Bank sector play an important role in the economy because it in the mediator between the depositors and loaners. The Central Bank of Kuwait (CBK) play major role in organized the bank system, CBK was established in 1968 law no. 32 and take over the previous Consul of Kuwait Trading the objectives of the CBK:

1. Issue the currency in behalf of the state
2. Stabilize the currency and ensure the easy transfer into different currency.
3. Direct the physical policy and monetary policy.
4. Determine the interest rate.
5. Supervise the bank system in Kuwait.
6. Government banking services.
7. provide financial advise to government.
In Appendix (1), there is a chart which explain the banking system, this system consist of types: a. CBK, b. Commercial banks and c. Specialized banks.

3. Literatures Background

There are a few research have been done in banking sector as market based research, one of them Genay, 1998 he assess the condition of Japanese banks and he emphasis on accounting earnings and the information content. He found there is negative relationship between security return and ROE (Return on Equity) and on the other hand, PLL (Provision for Loan Loss) has positive relation with security return.

They are many capital research in other industries such as Board, Day and Walker (1989): They investigated the information content of three measures of unexpected accounting performance: accounting income, working capital fund flow, and cash flow from operation. The results of their study were: unexpected accounting income has a more significant association with security return than unexpected fund flow and unexpected cash flow. Unexpected accounting income has incremental explanatory power beyond unexpected fund flow and unexpected cash flow.

Board, Day and Napier (1993) investigated share price reaction to earnings and cash flow disclosures. They concluded that cash flow variables are unlikely to prove superior to operating profit and earnings numbers in terms of their association with cumulative abnormal return.

Clubb (1995) addressed the information content of several cash flow variables: unexpected operating cash flow; unexpected investment cash flow; unexpected finance cash flow; and unexpected dividends. All the variables are (in first different form scale by
real share price. The real share price is the retail price index expressed on a per share basis) divided by the number of shares. Therefore all the variables are on a per share basis. For his study Clubb used time series data for 48 UK firms to carry out the information content test. He reported significant operation cash flow which is inconsistent with almost all UK studies, and he found significant association between unexpected investment, unexpected finance and unexpected dividends with unexpected returns.

4. Research Methods

This research is an empirical work which test the association between the market value and selected ratios from banks in Kuwait. The sample will be for all commercial banks that listed in Kuwaiti Stock Exchange for years 1997 to 1999, which is consist of 8 Banks with 3 years that is end up with 24 observations.

The ratios are:

ROTA = Return on Total Assets = Earnings before tax /Total Assets.
NIM = Net Interest Margin= (interest revenues –interest expenses) / Earning Assets
EAR = Earning Assets (EA) Ratio = EA / Total Assets.
BURDEN =(Non interest revenue –non interest expenses)/EA
LR = Loss Ratio = Provision for loan losses/EA
YOEA = Yield on Earning Assets = Interest Revenues (IR) /EA
MV = Market value of common stock.
The regression analysis will be used in this research using seven models to answer the following Questions:

1. Is the return on total assets has a value in security market in banking sector?
2. Are there any differences between NIM and Burden in term of the relation with market value?
3. Is the information about provision for loan loss has a value to the investors in security market?
4. Are they any information content of yield on earning assets beyond the information in earning assets ratio?

Based on the previous questions I develop the following models to answer them:

\[
MV_{it} = a + b \text{ROTA}_{it} + e_{it} \quad \text{.......................... M1}
\]
\[
MV_{it} = a + b \text{NIM}_{it} + e_{it} \quad \text{.......................... M2}
\]
\[
MV_{it} = a + b \text{BURDEN}_{it} + e_{it} \quad \text{................. M3}
\]
\[
MV_{it} = a + b \text{LR}_{it} + e_{it} \quad \text{......................... M4}
\]
\[
MV_{it} = a + b \text{EARN}_{it} + e_{it} \quad \text{............... M5}
\]
\[
MV_{it} = a + b \text{EARN}_{it} + \text{YOEA}_{it} + e_{it} \quad \text{............ M6}
\]

The regression analysis will be used Ordinary Least Square (OLS) Maddala, (1992) to solve for the above model.

5. Research Results

5.1. Descriptive Statistical:

Table 1 present statistical description for the given sample:

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>TrMean</th>
<th>StDev</th>
<th>SEMean</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROTA</td>
<td>24</td>
<td>0.01137</td>
<td>0.01100</td>
<td>0.01132</td>
<td>0.00577</td>
<td>0.00118</td>
</tr>
<tr>
<td>NIM</td>
<td>24</td>
<td>0.02767</td>
<td>0.02350</td>
<td>0.02709</td>
<td>0.01336</td>
<td>0.00273</td>
</tr>
<tr>
<td>EARN</td>
<td>24</td>
<td>0.6060</td>
<td>0.6090</td>
<td>0.6055</td>
<td>0.0940</td>
<td>0.0192</td>
</tr>
<tr>
<td>BURDEN</td>
<td>24</td>
<td>-0.00858</td>
<td>-0.00850</td>
<td>-0.00850</td>
<td>0.00186</td>
<td>0.00038</td>
</tr>
<tr>
<td>YOEA</td>
<td>24</td>
<td>0.10913</td>
<td>0.10250</td>
<td>0.10768</td>
<td>0.02306</td>
<td>0.00471</td>
</tr>
<tr>
<td>LR</td>
<td>24</td>
<td>0.00418</td>
<td>0.00300</td>
<td>0.00388</td>
<td>0.00428</td>
<td>0.00087</td>
</tr>
</tbody>
</table>
This description explain the mean of all the variables less than 1 except MV because it was in value and the remaining variables in ratios form. Since the total sample observations are 24 this consider small sample but consist of all commercial banks in Kuwait for three years.

The correlation analysis is presented in table 2, and exam the relationship among the variables and result on the ROTA has high correlation with most of the variables except LR. There is high correlation between YOEA and NIM because the interest revenues included in both variables. Also, most variables present high correlation with most variables. This give an indication of Multicolinearity problem (Christie…el, 1984) when I use multiple regression, so that I will use single regression for six models and the seventh are multiple regression.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Min</th>
<th>Max</th>
<th>Q1</th>
<th>Q3</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROTA</td>
<td>0.00300</td>
<td>0.02100</td>
<td>0.00600</td>
<td>0.01700</td>
</tr>
<tr>
<td>NIM</td>
<td>0.00800</td>
<td>0.06000</td>
<td>0.01650</td>
<td>0.03925</td>
</tr>
<tr>
<td>EARN</td>
<td>0.4430</td>
<td>0.7780</td>
<td>0.5320</td>
<td>0.6775</td>
</tr>
<tr>
<td>BURDEN</td>
<td>-0.01300</td>
<td>-0.00600</td>
<td>-0.01000</td>
<td>-0.00700</td>
</tr>
<tr>
<td>YOEA</td>
<td>0.08400</td>
<td>0.16600</td>
<td>0.09300</td>
<td>0.11900</td>
</tr>
<tr>
<td>LR</td>
<td>0.00000</td>
<td>0.01500</td>
<td>0.00077</td>
<td>0.00675</td>
</tr>
<tr>
<td>MV</td>
<td>117.7</td>
<td>940.7</td>
<td>158.9</td>
<td>396.9</td>
</tr>
</tbody>
</table>

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</tr>
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<td>117.7</td>
<td>940.7</td>
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<td>396.9</td>
</tr>
</tbody>
</table>

5.2. Regression Results:
The regression results are presented in table 3 for all the models, for the first question, is the return on total assets has a value in security market in banking sector?. The answer in M1, which is yes because the t-ratio is 4.77 and it was significant at 0.001 level and R² was 48.6%. That is mean there is an association between the market and ROTA and the
investors in security market consider the ROTA when they make the investment decision. But this results are inconsistent with Genay, 1998 finding because he found negative relation between return on equity and security returns.

The second question, are there any differences between NIM and Burden in term of the relation with market value?, the answer is yes, but with different signs. Because NIM has positive association and Burden has negative association (see table 3, M2 and M3) and all significant at 0.0001 levels, but the $R^2$ for NIM higher than Burden, because it is 71%, 35.2% for NIM and Burden respectively. This mean the spread of NIM has a big impact in the market and this result of that net interest is the main source of revenues from bank operation.

Therefore, the investors will pay attention to this figure and react positively when NIM was increased. On other hand, the market react negatively for the increase in Burden, this might be interpreted that the investors did not know the sources of the burden and also due to fact that Burden figure is negative (non interest expenses more than non interest revenue).

The third question, is the information about provision for loan loss has a value to the investors in security market?, there is no association between LR and the market and LR coefficient is insignificant so that this information is not important to the investors in security market (see table3, M4). On other hand Genay, 1998 found opposite results because he found positive relation between provision for loan loss and security return.

The forth question is, Are they any information content of yield on earning assets beyond the information in earning assets ratio?, the answer is yes because when we compare the $R^2$ between M5 and M7 in table 3 we found YOEA have more information content than earning assets ratio, but all significant at 0.0001 level.
## Table 3
### Regression for Individual Variables

<table>
<thead>
<tr>
<th>Model</th>
<th>Variable</th>
<th>Coef</th>
<th>P-Value</th>
<th>Adj R²</th>
<th>F-stat</th>
<th>P-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>M1</td>
<td>Constant</td>
<td>-12.95</td>
<td>0.874</td>
<td>48.6%</td>
<td>22.76</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>ROTA</td>
<td>30283 (4.77)</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M2</td>
<td>Constant</td>
<td>-99.58</td>
<td>0.129</td>
<td>71%</td>
<td>571.18</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>NIM</td>
<td>15582 (7.56)</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M5</td>
<td>Constant</td>
<td>1406.3 (5.64)</td>
<td>0.000</td>
<td>43.9%</td>
<td>19</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>EARN</td>
<td>-1773.8 (-4.36)</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M3</td>
<td>Constant</td>
<td>-364.1 (-1.88)</td>
<td>0.074</td>
<td>35.2%</td>
<td>13.47</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>BURDEN</td>
<td>-81048 (-3.67)</td>
<td>0.001</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M7</td>
<td>Constant</td>
<td>-669.9 (-5.26)</td>
<td>0.000</td>
<td>73.4%</td>
<td>64.48</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>YOEA</td>
<td>9177 (8.03)</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M4</td>
<td>Constant</td>
<td>330.5 (4.57)</td>
<td>0.000</td>
<td>0.0%</td>
<td>0.0</td>
<td>0.984</td>
</tr>
<tr>
<td></td>
<td>LR</td>
<td>242 (0.02)</td>
<td>0.984</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M6</td>
<td>Constant</td>
<td>-679.3 (-1.46)</td>
<td>0.01</td>
<td>72.1%</td>
<td>30.77</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>EAREN</td>
<td>9.8 (0.02)</td>
<td>0.983</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>YOEA</td>
<td>9208 (4.83)</td>
<td>0.000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Conclusion

This research examines the relationship between market value and selected accounting ratios in banking sectors in Kuwait. The findings are inconsistent with the previous study in some ratios, in this study we found provision for loan loss insignificant while Genary, 1998 found significant results. While other ratios have a significant results and important to the security market.

This study provides evidence to Kuwaiti investors about accounting ratios, which they must consider before making investment decision. This research is the first one deals with this issue in Kuwait for banking sector, therefore it will provide a contribution for investors, researchers and profession.
REFRENCES


