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## The Impact of Corporate Financing Decision on Corporate Performance in the Absence of Taxes: Panel Data from Kuwait Stock Market

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# **The Impact of Corporate Financing Decision on Corporate Performance in the Absence of Taxes: Panel Data from Kuwait Stock Market**

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## **Abstract**

This study examines the relationship between financing decisions such as capital structure, capital budgeting techniques and dividend policy along with the firm's attributes. We examined the impact of industrial sectors and financial performance using the panel data of 80 listed companies in Kuwait. The results of this study suggest that, contrary to the Trade-off Theory of capital structure, there is a negative association between the level of debt and financial performance. This can be attributed to the high cost of borrowing and the underdeveloped nature of the debt market in Kuwait. Given the unique tax environment in Kuwait, using debt does not seem to be sufficient to outweigh the costs of using debt, including the high interest cost.

The empirical findings also show that short-term debt has a significant and negative relationship with both accounting measure of performance ROA, while there is no impact of long-term impact. Because there is an inactive and underdeveloped bond market, firms tend to involve more short-term loans than long-term loans, which lead to the risk of refinancing their debt.

**Keywords: Corporate Performance, Capital Budgeting, Capital Structure, Dividend Policy, Debt Maturity, Kuwait**

## **Introduction**

Financing decisions such as capital structure, capital budgeting techniques and dividend policy are considered to be an important factor in an organization's ability to deal with its competitive environment. Whilst most of the existing literature focused on the determinants of a particular financial decision, this study pursued a new direction in this particular area of research by collectively investigating whether financial decisions are consistent with value maximization in an emerging market, in this case Kuwait.

Each decision of capital structure, capital budgeting and dividend policy related to corporate performance and the issues surrounding it prove to be useful to both academic and practitioners. For instance, the optimal investment decision maximizes the present value of the shareholder's wealth by using capital budgeting procedures (Copeland & Weston 1992). Large firms tend to make considerable amounts of expenditures for new plant and equipment, which may require the use of more capital budgeting techniques (Kim 1982). There is little consensus among researchers on whether the decision of dividend policy could influence a firm's performance. Profitable firms are said to be more likely to pay out dividends from their excess net earnings than less profitable ones because high levels of financial leverage indicate higher levels of debt burden for the firm as they reduce the firm's capability of paying dividends. Profitable firms are more certain of their current and future level of dividends than less profitable ones (Jensen, Solberg & Zorn 1992).

The objective of the study is to examine the effect of corporate finance decisions on corporate performance in Kuwait. There is a lack of empirical evidence about the effect of corporate finance decisions on corporate performance from both developed and developing countries. Most literature on corporate finance decisions focus on the determinants of corporate leverage, capital budgeting techniques and dividend policy. There is a gap in the existing literature regarding the impact of corporate finance decisions on corporate performance. The study aimed to fill the gap by exploring the effects of corporate finance choices on the corporate performance of companies in Kuwait.

We choose Kuwait as a case study for two reasons. Firstly, both bond and mutual funds markets in Kuwait are under developed and inactive. The underdevelopment and inactivity leaves room for banks to play an important role in financing firms listed on the Kuwait Stock Exchange.

Banks such as conventional commercial banks and Islamic banks mainly provide short-term rather than long-term loans, which explain the high reliance of Kuwaiti listed firms on this form of financing (Creane et al., 2003). Banks in Kuwait concentrate their lending to the service rather than the industrial sector, which normally requires long-term loans. Kuwait has unique financing arrangements characterized by high leverage and high reliance on bank debt. This fact differentiates Kuwait from the US. Welch (2004) posited that long-term debt issuing activity is the capital structure most relevant for the US, in contrast to short-term debt issuing in Kuwait. The fact that Kuwaiti listed firms depended on banks to finance their activities added further importance to the study. Existing literature often described banks as being particularly superior at investigating and deciding which companies are viable borrowers. Banks have an advantage in collecting information, but are more expensive sources of capital than the public debt markets. The cost of monitoring and, imperfect financial contracting would raise the costs of debt for firms borrowing from banks, thereby lowering their debt ratios (Faulkender & Petersen 2006). Kuwait's firms are highly levered, which seemed to conflict with the given costs of obtaining debt in Kuwait. Therefore, it is particularly important to investigate the impact all measures of leverage, particularly short-term debt and long term debt, may have on corporate performance.

Secondly, Kuwait has a simple environment where there are neither personal taxes nor corporate taxes on dividends and capital gain. This is different from most western countries, which are often characterized by the complexity of their tax codes. The existence of tax codes presented a difficulty in evaluating the importance of debt for most of the undertaken studies. The study may contribute to solving the capital structure puzzle. While complexity is true for western countries, particularly the US, it does not apply to some countries with no corporate tax rates such as Kuwait. To the researchers' best knowledge; none of the existing studies analyzed the financial decisions and their impact on emerging markets' firm performance. This study attempted to fill gaps in the literature by looking at the relationship of firms' financial decisions and their impact on firm performance on various emerging markets in listed Kuwaiti firms. The study was the first to explore corporate financial policies, which include capital structure and financial performance in the absence of personal taxes. Moreover, the study presented a different view on capital structure through the use of data from the Middle-East.

The following section discusses the literature review. Additionally, Section 3 discusses the methodology and empirical models used to examine the effect of corporate financial choices on corporate performance. Lastly, section 4 presents the analysis and discussion of results, while section 5 summarizes and concludes the paper.

## **2. Literature Review**

Whilst the literature empirically examines the determination of financial decisions, few studies focused on their association with the firm performance. Most of the existing literature includes Titman and Wessels (1988), Booth, Demircug-Kunt and Maskimovic (2001), Rigar and Mansouri (2003), Omet and Mashharawe (2003), Chen (2004), Pandey (2004), Song (2005), Mazur (2007), Bahsh and Sentis (2008); and, Crnigoj and Mramor (2009); these empirically focused on investigation of determining capital structural choices. Only a few studies , such as Pandey, Chotigeat and Ranjit (2000), Abor (2005), Zeitun and Tian (2007), Rao,Al-Yahae and Syed (2007), and Muradoglu and Sivaprasad (2009) focused on the capital structural choices' impact on corporate performance and found that a negative or insignificant effect has been caused to the firm's capital structure policy and its performance.

Nevertheless, a firm's choice of leverage is not the only factor that affects corporate performance. A corporate debt maturity structure is also believed to affect corporate performance (Morris 1975; Barclay & Smith 1995; Stohs & Mauer 1996; Ooi 1999; Ozkan 2000). Chen (2004) found that Chinese firms prefer short-term finance and have substantially lower amounts of long-term debt. Therefore, this finding must be considered carefully when viewed and interpreted in the context of the Chinese' developing nature of economy. Chen (2004) concluded that the trade-off model, also known as the Pecking Order hypothesis that is based on western settings failed to explain the capital structure preferences of Chinese firms. This could also be true for companies in Kuwait; the Kuwaiti financial market is still in a developing stage and has no personal or corporate taxes, unlike western countries.

Schiantarelli and Sembenelli (1999) investigated the impact of debt maturity on corporate performance for Italy and the United Kingdom. A positive relationship was found to exist between initial debt maturity and medium performance. Barclay and Smith (1995) provided

evidence that firms with few growth options and large firms have more long term debt. A similar study by Stohs and Mauer (1996) found that larger and less risky firms usually make greater use of long-term debt than smaller risk firms. They also discovered that debt maturity is inversely related to firm quality and the firm's effective tax rate, risk, and, growth opportunities, and is directly related to its asset maturity. Other studies, such as Guedes and Opler (1996), Barclay, Marx and Smith (2003) and, Scherr and Hulburt (2001) provided strong evidence that corporate debt maturity is negatively associated with growth opportunities. In other words, the choice of debt structure could have a great influence on corporate performance.

A firm's choice of capital budgeting is the most essential decision the financial managers have to deal with when evaluating projects based on the availability of funds. Financial managers tend to accept investments where the benefits exceed the costs after adjusting for the risk and timing of the cash flows. Therefore, capital budgeting is the process of determining which investment results in maximization of shareholder value. Financial managers and academics have not been in full agreement regarding the choice of the best capital budgeting method in both developed and developing countries. Empirical evidence from the developed countries, in contrast to less-developed countries, showed a positive impact of capital budgeting techniques on corporate performance (Pike 1986; Kim 1982; Durnev, Morck, Yeung & Zarowin 2001). At the firm level, capital investment could have a crucial impact on a firm's profitability. Research focusing on the relationship between firm performance and capital budgeting techniques is scarce. Most of the findings in the existing literature revealed a negative linear impact regarding the choice of capital budgeting techniques on corporate performance (Farragher, Kleiman & Sahu 2001; Durnev et al. 2001; Axelsson, Jakovicka & Kheddache 2002).

Although the choice of dividend policy is one major corporate decision faced by management today, it is still not fully understood in the area of corporate finance (Ooi 2000). A firm's choice of dividend policy is simply characterised as a constant payout ratio, which is a ratio of dividend paid to earnings. A firm's payout ratio usually varies over its life, which presents difficulty in choosing the appropriate dividend policy. The choice of dividend policy must be determined primarily by the firms' investment opportunities and internal needs for funds. Dividend payments convey information about the current and future profitability of a firm. The greater the

uncertainty between the current and future profitability, the more likely the firm experiences the risk of being less profitable. Existing literature empirically examined the determinants of corporate capital structure policy (Alli, Khan & Ramirez, 1993; Eriotis & Vasiliou 2003; Amidu & Abor 2006; Al Yahyae, Pham & Walter 2007; Nacelur, Goaid & Belanes 2007; Ahmad & Javid 2009). Sharma (2001), Nishat and Irfan (2003), and, Amidu (2007) found a positive effect on a firm's dividend policy and its performance. Sharma (2001) observed that share prices react positively to dividend initiation announcements. Nishat and Irfan (2003) also indicated that both the dividend policy measures have a significant impact on the share price volatility. Similarly, Amidu (2007) concluded that the dividend policy and dividend payout ratio have a significant impact on corporate performance in Ghana.

### **3. Estimation Method**

#### **3.1 Data**

The data used in this section was collected from various resources including the Kuwait Stock Exchange (KSE), Reuters, Global Investment House and Emerging Markets Information Service's (EMIS) database. The data set was comprised of all publicly traded firms listed at the KSE for the period from 2000-2008. The selected sample for this study is based on the availability of the data for the period of interest. All companies were required to issue their financial statements for every year between 2000 and 2008. The dataset contained detailed information about each firm. The dataset sample included 80 listed firms in Kuwait. The sample gathered for the study had 14 sectors, including both financial and non-financial companies. The information for all accounting related variables were collected and calculated from annual financial reports, namely, the balance sheets and the income statements, for each listed firm in Kuwait. All financial statements follow the requirements of international standards.

#### **3.2 Proxies Variables**

This research used the proxy (ROA) as an accounting performance measure and (Tobin's Q) as a market performance measure. Since it cannot be established whether it is better to use accounting information or stock information in the context of corporate finance decisions, we took into account both of these spheres. In addition, using both accounting and stock

performance measures could shed light on the stock market activity and aid in determining whether other factors affect corporate performance.

### **3.2 The Research Hypotheses and Empirical Model**

A firm's capital structure is measured by total debt (short-term debt and long-term debt) to capital (debt plus equity). In this study, Kuwait has a different financial system from the western countries, where banks tend to provide more short-term than long-term debts. It has been argued that short-term debt presents negative effects on a firm's performance because of the risk refinancing a firm brings. Myers and Majluf (1984) determined a negative relationship between performance and capital structure because firms tend to depend on their internal funds for expansion to lessen approximate cost. Furthermore, evidence from the emerging markets revealed a negative relationship between capital structure and performance (Pandey, Chotigeat and Ranjit 2000; Pandey 2004). This suggests that the capital structure has a negative influence on a firm's performance. Thus, hypotheses 1 and 2 are:

**H<sub>1</sub>: A firm's capital structure is expected to have a negative influence on its performance.**

**H<sub>2</sub>: A firm's short-term debt decreases its performance.**

The choice of dividend policy is defined using the dividend yield, which relates the dividend paid to the price of the stock and is defined as the dollar dividend per share divided by the current price per share. Listed firms in Kuwait seemed to follow one clear-cut hypothesis. Kuwait has a unique tax environment where there is no personal or corporate tax on dividends. Therefore, the tax preference hypothesis cannot hold true for this country since there is no tax law that can be identified on dividend payments in Kuwait. In fact, the investors in this country prefer companies that pay dividends to non-pay companies. Therefore, the bird-in-hand hypothesis will hold true for Kuwaiti investors. Thus, hypothesis 3 is:

**H<sub>3</sub>: A firm's dividend policy has a positive effect on its performance.**

A firm's choice of capital budgeting techniques is defined as the most frequently used techniques by respondent firms (or a dummy that takes the value of 1 if the company is using at least 2 or more of capital budgeting techniques and, the value 0 otherwise). Axelsson, Jakovicka and Kheddache (2002) established the existence of a positive relationship between capital budgeting choices and firm performance. Thus, hypothesis 4 is:

**H<sub>4</sub>: A firm's capital budgeting techniques is expected to have a positive influence on a firm's performance.**

A firm's size is measured by the natural logarithm of total assets. The firm's size is hypothesized to be positively related to the firm's performance. Wu (2006) found that a firm's size has a positive and significant effect on firm performance because a large size firm is an indication of a firm's market power or the level of concentrations in the industry. Having such characteristics may enable the firms to generate greater returns on assets and sales, as well as to capture more production value, leading to higher firm performance. Based on this discussion, hypothesis 5 is:

**H<sub>5</sub>: A firm's size is expected to have a positive influence on a firm's performance.**

Risk is measured by the standard deviation of earning divided by total asset used when accounting performance measures are used, and, defined as beta when market performance is applied. According to the classic risk return trade-off argument, firms with higher variability in operating income are expected to have higher returns. Thus, the hypothesis to be tested is as follows:

**H<sub>6</sub>: There is a positive relationship between risk and corporate performance.**

Growth opportunities are measured by growth of assets. It is expected that firms with high growth opportunities have high information asymmetry and use less percentage of debt. Firms in developing or emerging markets tend to use more equity to finance the growth of their assets than that of developed market firms. Developed market firms use higher levels of liabilities and,

the use of internal finance is similar between the markets (Glen & Singh 2003). For this reason, firms in Kuwait are expected to prefer equity over debt to finance their expansion. Firms with high growth opportunities may choose lower debt levels and thus demonstrate higher performance (Titman & Wessels, 1988 and Singh and Faircloth, 2005). Thus, hypothesis 7 can be stated as follows:

**H<sub>7</sub>: Growth opportunities increase corporate performance.**

The corporate finance decisions for firms vary from one sector to another (Capon, Farley & Hoenig 1990). Wei, Xie and Zhang (2005) further added that a firm's growth and business cycle varies from one industry to another. To be more specific, firms in industries that are more asset-intensive, such as manufacturing, tend to have a greater effect on performance than the firms in other industries. Since corporate financial choices, risk, growth, business cycle and sensitivity to external shocks may vary across industries, the corporate value would be affected differently. Thus, the industry sectors are expected to have an impact on corporate performance. Based on this discussion, hypothesis 8 is stated as:

**H<sub>8</sub>: Industrial sectors affect corporate performance.**

To control the effect of industrial sectors on corporate performance, 14 dummy variables were used and are as follows: Sector 1 (Banks), Sector 2 (Investment), Sector 3 (Insurance), Sector 4 (Real Estate), Sector 5 (Construction and Engineering), Sector 6 (Chemical and Petroleum), Sector 7 (Steel, Mining and Heavy Engineering), Sector 8 (Utilities and Energy), Sector 9 (Hotels and Tourism), Sector 10 (Warehousing and Transporting), Sector 11 (Trade and Commercial Services), Sector 12 (Telecommunication), Sector 13 (Education), and, Sector 14 (Food). Dummy variables would either take the value of 1 if the firm belongs to that sector; otherwise, it would take the value of 0.

The regression model takes the form of the Random Effects Model for balanced panel data (Greene 2003). The Random Effects model was better suited to the data set than the Fixed Effects model, because of the control necessary for the effect of the industrial sectors on the

firms' performance. The Fixed Effects model does not allow control for this effect due to the fact that industrial dummies do not change over time and are excluded in the Fixed Effects model. The usual identification tests and Hausman's Chi-square statistics were used for testing whether the Fixed Effects model estimator is an appropriate alternative to the random effects model (Judge et al. 1985). Furthermore, the Breusch and Pagan (1980) test for the random effect was also computed for each model.

$$y_{it} = \beta_0 + \beta_1 CSD_{it} + \beta_2 DIVID_{it} + \beta_3 CBDum_{it} + \beta_4 Size_{it} + \beta_5 Risk_{it} + \beta_6 Growth_{it} + \beta_7 TANGB_{it} + \beta_8 LIQUID_{it} + INDUST_{it} + \mu_{it}.$$

Where  $y_{it}$  is alternatively ROA, ROE, Tobin's Q, P/E, market cap (or Mcap), and stock return (or SRETURN) for firm  $i$  are known as measures of performance. The independent variables represented capital structure decisions (CSDs), the choice of dividend policy (DIVID), the capital budgeting techniques dummy variable (CBDum), Size, Risk, Growth, Tangibility and Liquidity. One measure of dividend policy was used in the study: dividend yield (DY) and, one measure of risk was used in the study standard deviation of earning divided by total assets. The other variables that might affect a firm's performance were the assets structure measured by tangibility and liquidity. Tangibility is defined as the ratio of fixed assets to total assets (TANGB), whereas liquidity is the ratio of current assets to total assets (LIQUID). Tangibility and liquidity were expected to be positively related to corporate performance. INDUST refers to the dummy variables for 14 industries used in this study.

## 4. Empirical Results

### 4.1 Descriptive Statistics

The summary statistics for the variables used in this study is reported in Table 1. The average return to equity was 12.3% for the whole sample, while the average return on assets was only 7.2%. The reported two accounting measures of performance indicated that Kuwaiti firms have low accounting performance. The five measures of market performance showed high percentages of performance, which are being compared with accounting measures. For example, the average values of Tobin's Q and MPBV were 173% and 217%, respectively. The high ratios for the

market performance measures could be a result of the increase in the firms' share price and equity without any increase in the real activities' performance of the firm. The lower accounting returns might also be affected by the firms' leverage. The average total debt to total assets for the sample as a whole was about 115 %.

To examine the correlation among the explanatory variables, Table 2 reported the pairwise correlation matrix for these variables. Results showed that a strong negative relationship exists between growth and leverage, while size has a strong negative relationship with all leverage indicators with the exception of TDTE and TDTC. Furthermore, a positive relationship between size and growth was observed. This implied that larger companies with higher growth opportunities tend to have a higher leverage ratio. Results also have shown that most Kuwaiti companies with higher leverage ratios were more likely to have a higher level of risk than the ones with a lower leverage ratio. This implies that leveraged firms have high risks as debt holders have possibilities or tendencies to take over the firm.

<INSERT TABLE 1>

<INSERT TABLE 2>

## **4.2 Discussion**

As proposed in hypothesis 1, the firm's decision of capital structure was expected to influence its performance. In this study, there are three variables of capital structure used: TDTA, STDTA and LTDTA. In most cases, the coefficients of those variables are significantly and negatively related to accounting performance measures (ROA). Krishnan and Moyer (1997), Gleason, Mathur and Mathur (2000), and others, mentioned that one explanation comes from the agency proposition, which states that companies tend to over-leverage themselves to negatively affect their performance. Another explanation stemmed from Myer's pecking order theory where profitable firms preferred to generate funds internally rather than externally. Table 3 displayed the results of the regression estimation for each performance measure.

Due to the absence of a well developed and a very liquid bonded market, Kuwaiti companies depended on banks for debt financing. The interest cost in Kuwait is very high as compared to western countries. Even companies known as well-performers at the operating profit level turned

out to be poor financial performers at the net profit level due to the high interest cost. Hence, until a well-developed bond market ceases to level out, it would be practical for Kuwaiti companies to reduce their debt financing and use internal cash flow or equity to meet their financing needs.

The STDTA ratio is found to have significant and negative effect on the accounting performance measure ROA. It was also found that STDTA have a significant and a positive effect on Tobin's Q. These findings indicated that short-term debt exposed firms to experience risks in terms of significant coefficients for short-term debt reflected strong facts about banks, which are intensely providing enterprises with short-term loans. Therefore, it is concluded that short-term debts tend to decrease corporate accounting performance ROA.

Furthermore, while no impact of LTDTA was seen on the accounting performance firm measure, the coefficient of LTDTA is found to be positively and significantly related to Tobin's Q. This result does not support Brick and Ravid's (1985) argument that long-term debt increases a firm's value. This was a strong indication of lower levels of long-term debt in capital structure among Kuwaiti firms. These results were consistent with the fact that the bond market is still underdeveloped and non-existent.

The capital structure ratio, which is related to TDTA is found to be significantly and positively affecting the market performance measure Tobin's Q. Interestingly, STDTA had also shown a positive and significant coefficient, which indicated that higher levels of short-term debt in the capital structure are associated with a higher ratio of Tobin's Q.

Hypothesis 3 predicted that a firm's dividend policy has a positive effect on its performance. A firm's dividend policy was found to have a positive and significant coefficient on the accounting measures of corporate performance ROA, and, insignificant coefficients in relation to Tobin's Q. This result is consistent with the previous studies that included Baker and Powell (1999), among others. The results supported the bird-in-hand argument, which argued that shareholders may prefer cash dividends due to their certainty as they are received immediately, while any returns from reinvestments that will occur in the future are subject to more uncertainty. Moreover, this

result may also reduce problems that occur in an agency. This implied that high dividend payments reduced the required rate of return and thereby enhanced firm value. It is then concluded that dividend policy has a positive impact on corporate performance.

From hypothesis 4, a firm's capital budgeting decision is expected to have a positive influence on its performance. The capital budgeting techniques are found to have insignificantly impacted marketing measure of performance (Tobin's Q). On the other hand, it exhibited a positive and significant impact on ROA. Nevertheless, this also confirmed that Kuwaiti companies applying capital budgeting techniques could affect the company's firm value positively. Therefore, hypothesis 4 predicted a negative relationship between capital budgeting techniques and corporate performance.

A firm's size is expected to influence its performance as predicted in hypothesis 5. The results showed that a firm's size is significantly and negatively related to other measures of performance ROA and Tobin's Q. This could be interpreted that large firms are less efficient because of the loss of control by top managers over strategic and operational activities within the firm. Rejection of the hypothesis is done since the firm size increases corporate performance.

Hypothesis 7 predicted that the firm's growth opportunity is expected to reflect its performance. Growth had a positive and significant impact on both measures of firm performance ROA and Tobin's Q. This indicated that high growth rates are associated with high performance. This result was consistent with previous findings by Singh and Faircloth (2005), among others. The firm's growth was then considered an important determinant of corporate performance.

A firm's risk level is expected to influence its performance as predicted in hypothesis 6. It is not significantly, but is positively related to performance measures. This result is in line with the classic risk-return trade off argument, in which firms with higher variability in operating income are expected to have higher returns. Therefore, null hypothesis 6 is accepted, which predicts a positive relationship between risk level and corporate performance.

Liquidity had a negative and significant impact on the accounting measure of performance ROA. This result indicated that firms with a high ratio of LIQ would have a larger margin safety net, which the company possesses to cover their short-term obligation. The lower performance implied that Kuwaiti companies invested in liquid assets in such a way that their investment did not improve their performance. It can also be interpreted that companies do not use their liquidated assets efficiently; wherein, liquidity in turn had a negative impact on their performance. The composition of the asset structure (TANG) has a insignificant impact on every measure of performance, which also indicated that Kuwaiti companies were using their fixed assets inefficiently, which created no impact on their corporate performance.

<INSERT TABLE 3>

#### **4.2.1 Industrial Sectors**

To capture the effect industrial sectors have on corporate performance, this study added industrial dummy variables to the model. Hypothesis 9 predicted that industrial sectors affected corporate performance. Table 5 showed that the industrial dummy variables for sector 5 (Construction and Engineering) and sector 9 (Hotels and Tourism) are significantly and positively related to the accounting measure of ROA using TDTA, STDTA and LTDTA as a measure of capital structure. The significant and the positive impacts of these industrial dummy variables indicated a higher level of investment in these sectors, which could be associated with a higher ratio of ROA.<sup>1</sup> The high profitability of sector 5 (Construction and Engineering using TDTA, STDTA and LTDTA) might indicate that Kuwait is engaging in petroleum industry related activities with varied interest in turnkey projects, such as engineering and constructing. The positive and significant impact of sector 9 (Hotels and Tourism) using all measure of capital structure might indicate that the tourism industry is profitable, as it is part of the diversification plan of the Kuwaiti economy to avoid its heavy reliance on oil. The negative impacts of sector 11 (Trade and Commercial Services) on both accounting measures of performance ROA and Tobin's Q are results of reduction in oil prices on Kuwait's total exports and current account surpluses. The deceleration in net government expenditure, in addition to the difficulties in the

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<sup>1</sup> It should be noted that the significance of these industrial sectors may imply the presence of the industry sector. It is also note worth noting that we have introduced each industrial dummy separately in each of the regression models to capture its effect separately.

stock market instability had contributed to the depressed value of Kuwaiti's trade. Therefore, this decreases the performance of listed firms in terms of ROA and Tobin's Q. The dummy variables, which had significant impacts on the market measure Tobin's Q are sector 3 (Insurance), sector 7 (Steel, Mining and Heavy Engineering), sector 5 (Construction and Engineering), sector 9 (Hotels and Tourism), sector 11 (Trade and Commercial Services) and sector 12 (Telecommunication).

<INSERT TABLE 4>

Some firms in the industries showed negative signs as a result of negative equity values. Therefore, the hypothesis that industrial sectors affect Kuwaiti's corporate performance on ROA should be accepted. The significance and signs of these industrial sectors changed as the performance measure transitioned over time. This implied the presence of the industry sector. It is important to note that industrial dummy variables should be included in the regression model to increase its robustness and accuracy.

## **5. Conclusions**

This study examined the effect of corporate financial decisions, capital structure, dividend policy and capital budgeting, along with the firm's attributes, in which we control for the impact of industrial sectors. This research bridged the gap in the relevant literature as state and regional development varies from one country to another, which could affect the validity of theories as the environment changes.

To the best of our knowledge, there was no single study found in the Middle East that jointly investigated the impact of capital structure, dividend policy and capital budgeting on a firm's performance. Therefore, this study tried to fill the gap in the existing literature by investigating the effect of corporate finance decisions in Kuwait as a case study. Furthermore, different measures of capital structure such as short-term debt, long-term debt and total debt to total assets were used in this study. Investigating the effect of corporate finance choices on corporate performance using accounting and market measures could be valuable as it shed lights on the evidence of stock market efficiency.

A balanced panel data of 80 companies (or 720 observations) are inspected in this study. The empirical findings provided the evidence that capital structure has a significant and negative linear relationship with both accounting and marketing measures of performance. This empirical finding showed support for the asymmetric information hypothesis of Myers (1984) and Myers and Majluf (1984). This finding postulated that companies prefer internal financing to debt to equity. Firms with higher profitability tend to employ higher retained earnings and less debt. On the contrary, this result contradicted the trade-off theory of capital structure in the case of Kuwait. Conversely, this could also be attributed to the high cost of borrowing and the underdeveloped nature of the debt market in Kuwait. In addition, given the unique tax environment in Kuwait, no corporate tax rate in Kuwait implies that debt does not benefit from a tax shield in Kuwait as it does in western countries. Hence, at this time, it makes less sense for Kuwaiti firms to use a high level of debt in their capital structure and, this may not be a prudent strategy because doing so does not confer tax benefits as it does in western countries. From this perspective, what does this would inform managers with? The researchers believe that a manager could operate a business effectively without going into debt because incurring high amounts of debts in capital market is fraught with risks.

Another interesting finding was that STDTA was found to have significant and negative effect on ROA. There is no impact of LTDTA. Possible explanations of this result indicated that short-term debt exposed firms have to address the risk of refinance. There needs to be reflection on the important role of banks in providing] enterprises with more short-term loans rather than involving themselves with long-term debt. As discussed earlier, this important fact shed some lights on the chief uniqueness in the Kuwait environment, where the bond and mutual funds markets are still inactive and underdeveloped to commence long-term bonds.

Nevertheless, as Kuwait entered the post-war recovery phase, the reform of the financial market seemed essential to accelerate economic growth. Kuwaiti shared issue privatization as an ongoing program. Management of state holding companies has become the Kuwaiti's government priority. The stock market in Kuwait is less information efficient. Therefore, the issue of corporate governance became necessary to investigate in the lights of ownership

concentration and structure and, its effect on firm performance, which leave a room for further research.

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**Table 1: Summary Statistics of the Explanatory Variables, 2000-2008**

Variable	Mean	Std. Dev.	Min	Max	Skewness	Kurtosis	Shapiro-Wilk	Probability
ROE	0.123	0.217	-3.078	<b>0.786</b>	-5.940	75.327	174.243	0.000
ROA	0.072	.108	-0.806	0.663	-1.635	20.281	85.881	0.000
Tobin's Q	1.725	1.313	0.213	13.286	2.164	12.517	85.319	0.000
SRETURN	0.194	0.683	-0.900	9.370	5.515	66.030	139.798	0.000
MPBV	2.174	1.547	0.290	31.360	9.971	179.014	208.423	0.000
PE	12.430	12.727	-52.100	106.600	1.346	15.858	90.337	0.000
Mcap	0.411	0.876	-0.835	10.457	3.943	34.670	119.827	0.000
TDTA	1.154	1.224	0.007	12.632	2.503	15.327	108.058	0.000
STDIA	0.573	0.763	0.002	12.139	5.963	77.122	179.336	0.000
LDTA	0.582	0.804	0.000	6.397	2.661	12.065	147.618	0.000
DY	4.125	2.583	-5.430	18.450	0.845	5.761	16.678	0.000
Size	5.050	0.688	3.442	7.078	0.449	3.230	11.055	0.000
Growth	23.523	35.786	-47.630	622.140	7.630	114.626	185.517	0.000
STDVE	1.250	2.327	.004	17.810	4.029	21.825	232.024	0.000
LIQ	0.552	0.388	0.022	4.724	3.050	26.122	90.576	0.000
TANG	0.382	0.340	0.005	4.094	0.116	4.560	149.907	0.000

Note: ROA= return on assets; Tobin's Q= the market value of equity less debt to total assets; TDTA= total debt to total assets; STDIA= short-term debt to total assets; LDTA= long-term debt to total assets; DY= (dividend yield) dollar dividend per share divided by the current price per share; Size= log (assets); Growth= Growth opportunities measured by growth of assets; STDVE = standard deviation of earning to total assets; LIQ= liquid or current assets to total assets; TANG=the fixed assets to total assets.

**Table 2: Correlation Matrix of the Explanatory Variables during 2000-2008**

	TDTA	STDIA	LDTA	DY	Size	Growth	Risk	LIQ	TANG
TDTA	1								
STDIA	0.767***	1							
LDTA	0.794***	0.224***	1						
DY	0.04	0.103***	-0.037	1					
Size	-0.320***	-0.232***	-0.267***	0.025	1				
Growth	-0.090**	-0.133***	-0.012	-0.041	0.056	1			
STDVE	0.269***	0.223***	0.197***	-0.001	-0.600***	-0.088**	1		

<b>LIQ</b>	0.007	0.065*	-0.054	0.066*	-0.039	-0.120***	0.091**	1
<b>TANG</b>	0.069*	0.0359	0.070*	0.018	0.024	-0.027	0.135	-0.038

Note: \*\*\* Significant at 1% level, \*\* Significant at 5% level, \* Significant at 10%. TDTA= total debt to total assets; STDTA= short-term debt to total assets; LTDTA= long-term debt to total assets; DY= (dividend yield) dollar dividend per share divided by the current price per share; Size= log (assets); Growth= Growth opportunities measured by growth of assets; STDVE= standard deviation of earning to total assets; LIQ= liquid or current assets to total assets; TANG=the fixed assets to total assets.

**Table 3: The Results of Regression Estimation Using TDTA, STDTA, and LTDTA for Panel Data**

	TDTA			STDTA			LTDTA		
	ROA	Tobin's Q	ROA	ROA	Tobin's Q	ROA	Tobin's Q	Tobin's Q	
<b>Constant</b>	0.1429	3.2206	0.1422	0.1258	5.5342	0.1258	4.8397		
	(3.14)***	(7.76)***	(3.20)***	(2.78)**	(9.20)***	(2.78)**	(8.00)***		
<b>Debt</b>	-0.0049	1.0824	-0.01147	-0.0001	1.1257	-0.0001	1.1311		
	(-1.46)	(43.27)***	(-2.23)**	(-0.03)	(20.25)***	(-0.03)	(21.23)***		
<b>DIVID</b>	0.0121	0.0048	0.0123	0.012	-0.0037	0.012	0.0279		
	(8.36)***	-0.49	(8.50)***	(8.29)***	(-0.24)	(8.29)***	(1.88)**		
<b>CBDummy</b>	0.0174	0.2187	0.017	0.0181	0.1561	0.0181	0.1117		
	(1.90)*	(1.96)**	(1.88)*	(1.99)**	-1	(1.99)**	-0.7		
<b>Size</b>	-0.028	-0.4965	-0.0279	-0.0257	-0.8186	-0.0257	-0.7099		
	(-3.46)***	(-6.71)***	(-3.50)***	(-3.18)***	(-7.58)***	(-3.18)***	(-6.56)***		
<b>Growth</b>	0.001	0.0034	0.001	0.001	0.0035	0.001	0.002		
	(9.82)***	(5.05)***	(9.68)***	(9.91)***	(3.39)***	(9.91)***	(2.04)**		
<b>SDVE</b>	-0.0008	0.0083	-0.0007	-0.0011	0.01551	-0.0011	0.0392		
	(-0.36)	(-0.46)	(-0.29)	(-0.47)	-0.75	(-0.47)	-1.45		
<b>LIQ</b>	-0.0195	0.119	-0.0188	-0.0192	0.0539	-0.0192	0.1061		

<b>TANG</b>	(-1.97)**	(1.66)*	(-1.91)*	-0.5	(-1.93)**	-0.99
	0.0088	0.0361	0.0085	0.0218	0.0081	0.0449
	-0.82	-0.52	-0.8	-0.2	-0.76	-0.43
<b>R-Square</b>	0.212	0.7557	0.2284	0.4283	0.2118	0.4478
<b>Wald Test</b>	193.44	2367.76	196.85	632.02	190.52	677.28
<b>P-value</b>	(0.00)***	(0.00)***	(0.00)***	(0.00)***	(0.00)***	(0.00)***
<b>Breusch and Pagan Test</b>	8.32	307.66	9.11	251.59	6.11	268.93
	(0.0039)***	(0.00)***	(0.0025)***	(0.00)***	(0.0134)**	(0.00)***
<b>Hausman Test</b>	24.81	9.43	28.62	21.31	11.58	7.75
	(0.0008)***	-0.2231	(0.0002)***	(0.0033)***	-0.1151	-0.3556
<b>No. Observation</b>	720	720	720	720	720	720

Note: \*\*\* Significant at 1% level, \*\* Significant at 5% level, \* Significant at 10%. Numbers in the parentheses are z-values. ROA= return on assets; Tobin's Q= the market value of equity less debt to total assets; Debt is measured as TDTA= total debt to total assets; STDTA=short term debt to total asset; LTDTA= long term debt to total asset; DIVID= dividend policy we use DY= (dividend yield) dollar dividend per share divided by the current price per share; Size= log (assets); Growth= Growth opportunities measured by growth of assets; STDVE = standard deviation of earning to total assets; LIQ= liquid or current assets to total assets; TANG=the fixed assets to total assets.

**Table 4: The Estimation Output Using TDTA, STDTA, LTDTA and Dummy Variables for Industrial Sectors**

	TDTA			STDTA		LTDTA
	ROA	Tobin's Q	ROA	Tobin's Q	ROA	Tobin's Q
<b>Constant</b>	0.1407	3.7544	0.1585981	5.360089	0.140687	5.228376
	(3.06)**	(6.41)***	(2.79)***	(7.57)***	(2.43)**	(7.35)***
<b>Debt</b>	-0.005	1.0841	-0.0098679	1.125308	-0.0007	1.128017
	(-1.47)	(44.28)***	(-1.93)*	(20.22)***	(-0.14)	(21.15)***

<b>DIVID</b>	0.012	0.0053	0.0128566	0.001362	0.012477	0.0347804
	(8.36)***	-0.54	( 8.69 )***	(0.09)	(8.47)***	(2.33)**
<b> CBDummy</b>	0.0179	0.2216	0.0147533	0.122895	0.015803	0.1186104
	(1.92)**	(2.14)**	(1.58)	(0.76)	(1.63)	(0.69)
<b>Size</b>	-0.028	-0.494	-0.030606	-0.8272859	-0.02756	-0.8082328
	(-3.41)***	(-5.90)***	(-2.83 )***	(-6.42 )***	(-2.51)**	(-6.32 )***
<b>Growth</b>	0.001	0.0034	0.0010262	0.0035505	0.001048	0.0021452
	(9.74)***	(5.11)***	(9.81 )***	(3.41 )***	(10.02)***	( 2.12 )**
<b>SDVE</b>	-0.0007	-0.019	-0.0022619	0.0073363	-0.00229	0.0173108
	(-0.31)	(-1.04)	(-0.92)	(0.26)	(-0.92)	(0.61)
<b>LIQ</b>	-0.02	0.1261	-0.0146786	0.0366956	-0.01562	0.1351252
	(-1.98)**	(1.77)**	(-1.45)	(0.33)	(-1.52)	(1.25)
<b>TANG</b>	0.0087	0.0483	0.0086613	0.0316164	0.008704	0.0438982
	(-0.81)	(-0.7)	(0.82)	(0.29)	(0.82)	(0.42)
<b>DummySector 1</b>	-0.01	-0.062	-0.0085981	-0.0460373	-0.0115	0.2365528
	( -0.54 )	(-0.30)	(-0.44)	(-0.16)	(-0.59)	(0.79)
<b>DummySector 2</b>	0.0026	-0.14	0.001287	0.1253632	0.00138	-0.1416278
	(-0.27)	(-1.22)	(0.14)	(0.79)	(0.14)	(-0.86)
<b>DummySector 3</b>	-0.049	-0.41	-0.050062	-0.8326807	-0.04412	-0.8455543
	(-2.10)**	(-1.47)	(-2.16)**	(-2.12)**	(-1.90)*	(-2.17)**
<b>DummySector 4</b>	-0.008	-0.295	-0.0060673	-0.1112752	-0.01032	0.0938461
	(-0.63)	(-2.01)**	(-0.49)	(-0.54)	(-0.83)	(0.43)

<b>DummySector 5</b>	0.0296 (1.83)**	0.1675 (-0.86)	0.0293824 (1.83)*	-0.1509934 (-0.55)	0.032067 (1.97)**	-0.0525297 (-0.19)
<b>DummySector 6</b>	-0.006 (-0.25)	-0.073 (-0.26)	-0.0057008 (-0.25)	-0.0084568 (-0.02)	-0.0061 (-0.26)	-0.0473365 (-0.12)
<b>DummySector 7</b>	0.0229 (-1.27)	0.2846 (-1.35)	0.0211014 (1.18)	0.601678 (2.05)**	0.021221 (1.17)	0.2497281 (0.82)
<b>DummySector 8</b>	0.0156 (-0.41)	0.569 (-1.21)	0.0141106 (0.37)	0.4741551 (0.71)	0.017572 (0.45)	0.2482457 (0.37)
<b>DummySector 9</b>	0.0768 (2.04)**	1.1976 (2.62)***	0.0742209 (1.98)**	1.13669 (1.74)*	0.079178 (2.09)**	0.6611416 (0.98)
<b>DummySector 10</b>	0.0115 (-0.42)	0.2899 (-0.86)	0.0117914 (0.43)	-0.1088631 (-0.23)	0.01457 (0.53)	0.0189657 (0.04)
<b>DummySector 11</b>	-0.094 (-3.47)***	-0.597 (-1.79)**	-0.0927293 (-3.47)***	-1.22482 (-2.64)***	-0.08915 (-3.29)***	-1.029049 (-2.13)**
<b>DummySector 12</b>	0.0199 (-1)	1.0253 (4.71)***	0.0221395 (1.12)	0.6911985 (2.06)**	0.02073 (1.04)	1.163647 (3.63)***
<b>DummySector 13</b>	-0.041 (-1.49)	-0.45 (-1.33)	-0.0410905 (-1.5)	-0.6535252 (-1.38)	-0.03949 (-1.43)	-0.5940026 (-1.23)
<b>DummySector 14</b>	0.0076 (-0.36)	0.1106 (-0.43)	0.0079764 (0.38)	-0.2545777 (-0.70)	0.010221 (0.48)	-0.08515 (-0.23)
<b>R-Square</b>	0.2529	0.7559	0.2546	0.6033	0.2517	0.6221
<b>Wald Test</b>	230.19	2677.2	234.28	705.73	226.21	736.55

P-value	(0.00)***	(0.00)***	(0.0000)***	(0.0000)***	(0.0000)***	(0.0000)***
<b>Breusch and Pagan Test</b>	7.51	299.18	0.22	117.26	0.01	135.51
	(0.01)*	(0.00)***	(-0.6391)	(0.0000)***	(0.9106)	(0.0000)***
<b>Hausman Test</b>	23.19	6.34	32.63	35.36	8.88	6.82
	(0.00)***	(-0.61)	(0.0001)***	(0.0000)***	(0.3525)	(0.5558)
<b>No. Observation</b>	720	720	720	720	720	720

Note: \*\*\* Significant at 1% level, \*\* Significant at 5% level, \* Significant at 10%. Numbers in the parentheses are z-values. ROA= return on assets; Tobin's Q= the market value of equity less debt to total assets; TDTA= total debt to total assets; TDTE= total debt to total equity; TDTC= total debt to total capital; DIVID= dividend policy we use DY= (dividend yield) dollar dividend per share divided by the current price per share; Size= log (assets); Growth= Growth opportunities measured by growth of assets; STDVE = standard deviation of earning to total assets; LIQ= liquid or current assets to total assets; TANG=the fixed assets to total assets.