

Corporate governance and corporate finance practices in a Kuwait Stock Exchange market listed firm: a survey to confront theory with practice

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Abstract

Purpose – This paper aims to explore the issue of corporate governance mechanisms by including the importance of stakeholders, primary objectives of the firm and the ownership of top financial managers of listed firms in Kuwait in the survey tool. It attempts to investigate whether theory aligns with the behaviour of financial managers in practice in an emerging market case.

Design/methodology/approach – A survey was developed to focus primarily on the current corporate finance practices implemented by CFOs in listed companies in Kuwait. The target respondents are listed firms in the Kuwaiti Stock Exchange (KSE). The survey includes questions on topics that are closely related to capital budgeting, capital structure, cost of capital and dividend policy. For example, the survey asks the managers how they estimate their cost of equity (CAPM or other methods) and whether the impact of the weighted average cost of equity is taken into consideration in their capital structure choices.

Findings – A surprising number of firms are now widely using IRR for decision making. CAPM is also in use, whereas WACC remains the most popular method used. There is some support for the “bird-in-hand” dividend theory in the tax-free environment. Firms in Kuwait do not have any particular source of capital structure choices when it comes to how best to finance their projects as is the case in the US market. Firms in Kuwait are consciously striving for maximizing profits and those managers are regarded as their most important stakeholders. This may indicate the existence of agency problems.

Research limitations/implications – The limitation of this study lies in the absence of empirical investigation on how corporate finance decisions may affect firms’ performance in Kuwait. Hence, empirical validation will be performed by the authors in the next stage of this research, which will form the basis for further research. Empirical validation for the impact of corporate governance on performance is needed.

Practical implications – This research may benefit managers and decision makers in many aspects, including having an understanding of applying popular and the most suitable corporate finance and corporate governance techniques in the management of their companies. In this research, the authors have identified the gap between practice and academia.

Originality/value – To the best of the authors’ knowledge, this is the first study to examine comprehensively major areas of financial policies and practices and corporate governance in an emerging market case, especially in the Middle East. Kuwait provides a unique institutional setting in its taxation system. Therefore, this study will make a contribution to the general literature in this field.

Keywords Corporate governance, Corporate finances, Emerging markets, Financing, Kuwait

Paper type Research paper

1. Introduction

A substantial body of academic research describes the optimal decisions that corporations should formulate. However, there is evidence suggesting that the way corporations actually

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make decisions in practice is not always inline with the decision rules and theories that come from this research. To investigate whether theory aligns with the behavior of financial managers in practice, we applied and analyzed a comprehensive survey that describes many corporate finance issues, ranging from capital budgeting techniques to capital structure, cost of capital, dividend policy and corporate governance. This allows us to measure the extent to which theoretical concepts have been adopted by professionals and business practitioners from a broad range of listed firms in Kuwait.

Corporate governance has been a well-known topic of academic research for a long time in the Anglo-Saxon literature, in places like the UK and the USA. However, corporate governance mechanisms vary around the world. Investor protection laws in developed countries often propose duties for managers for being loyal to their investors and hence always maximize the shareholder wealth within their firms. Therefore, this leads to a better corporate governance mechanism. In contrast, there is weak law enforcement for management in non-Anglo-Saxon countries like Japan; however, there is more reliance on control of large investors. While concentrated ownership structure is a distinguishing feature across Europe, corporate law play a minor role (Gugler, 2001). The role of corporate governance suggests that shareholder's value maximization of the firm is an outcome of these mechanisms. It is also argued that large shareholders have incentives to monitor management and hence reduce agency costs (La Porta *et al.*, 1999).

In this study, we explore the issue of corporate governance mechanisms by including the importance of stakeholders, primary objectives of the firm and the ownership of top financial managers of listed firms in Kuwait in our survey tool. In doing so, we explore and analyze whether the corporate governance mechanism is associated with the managerial decisions of corporate finance.

Most prior research has focused on developed countries like the USA and the UK. However, there is now increasing awareness that theories originating from developed countries may have limited applicability and may not find their way in the developing countries. There are differences in the nature, direction, magnitude and processes of operation of the relationship between developed and developing financial markets due to differences in their economic, social, regulatory framework and market behavior (Heinrich, 2002; Ahunwan, 2003). Little is known about the roles of corporate governance mechanisms in developing countries. Hence, there is substantial need for such theories to be tested in contexts of emerging markets, i.e. Kuwait, which are characterized by different political, economic, cultural, institutional, social and other factors. Corporate governance frameworks originating from developed countries may have limited applicability to developing countries (Bushman and Smith, 2001).

Emerging markets like Kuwait offers us with a unique case study for three reasons. First, Kuwait provides a unique natural setting to test corporate finance theories because of the simplicity of its tax system – there are neither personal taxes nor corporate taxes on dividends and capital gain. This is markedly different from western countries, which are characterized by the complexity of their respective tax codes. Additionally, the dynamic nature of the treatment of tax shields in the American tax system makes it difficult to evaluate the quantitative importance of debt. Prior studies have found it difficult to evaluate the importance of debt. Thus, this will contribute to the capital structure puzzle in terms of quantifying the corporate tax rates and incentives. It may help us obtain clearer conclusion on firms' financing decisions.

Second, as Kuwait enters the post-war recovery phase, the on-going reform of the financial market becomes essential to accelerate its economic growth. Kuwait has recently started adopting several economic reforms, namely privatization or the process of deregulation, to pave the way to stimulate the activity of the stock market, improve corporate governance and economic growth and foster international integration. Hence, the issue of corporate governance mechanism becomes essential to explore within listed firms. Moreover, despite the fact that the Kuwait Stock Exchange (KSE) is a relatively young and recent stock market in the region, there is inadequate legislation to protect minority shareholders, poor



monitoring practices, lack of disclosures, inefficient and weak institutions and a large amount of information asymmetry. Such imperfections aggravate issues that are thought to be important for financial decision-making and highlights difficulties that may lie in the financial executive's path.

Third, despite the fact that the Kuwait Stock exchange (KSE) is the second largest market in the Arab world, it remains the only market in the GCC without a capital market authority (CMA). A CMA can be defined as an independent body that supervises trading procedures, monitors transactions, and detects conflict of interest. It also can resolve conflicts between investors and companies, enhance transparency of information, regulate takeover and merging operations, and penalize illegal activities. In short, CMA would enforce a stricter code of conduct and ensure the value of listed firms met with international standards. Moreover, Kuwait has also experienced a wave of financial sector liberalization. Because the government's recognition of the importance of the capital market for economic growth, the government has to establish a new legal framework like CMA to attract foreign investors and allow access to foreign investors to the market by protecting investor's rights through prohibiting unfair market practices as part of the liberalization program.

This paper contributes to the literature in a number of ways. Firstly, it explores the field study method in finance, which to date remains a relatively rare approach in this discipline. Second, many previous studies that apply a comprehensive survey approach focuses on developed countries such as the USA, UK and Europe. To the best of our knowledge, this is the first study to comprehensively examine major areas of financial policies and practices and corporate governance in Kuwait[1]. Since Kuwait provides a unique institutional setting in its taxation system, this study will make a contribution to the general literature in this field. Thirdly, this study is broader in scope than other related surveys because it employs exactly the same questionnaire used in previous research in North America, Europe, and India. Fourthly, this study examines the relationship between the CFO's[2] characteristics, such as education level, age and tenure years and a firm' size, equity, sector, and target debt ratio and corporate finance practices. Finally, this study also highlights the similarities and the differences between emerging and developed markets.

The remainder of this paper is organised as follows: Section 2 presents a brief literature review. Section 3 provides a brief description of the methodology. We summarize information on firm and managers characteristics in section 4. Section 5 presents survey results. Section 6 summarizes and concludes.

2. Literature review

Survey studies have a long tradition in finance literature. Although most studies focused on the USA (i.e. Lintner, 1956; Gitman and Forrester, 1977; Gitman and Mercurio, 1982; Stanley and Block, 1984; Epps and Mitchem, 1994; Poterba and Summers, 1995; Billingsley and Smith, 1996; Bruner *et al.*, 1998; Block, 1999; Graham and Harvey, 2001; Brav *et al.*, 2005), international survey research have been documented as well. Most studies focused on the UK (i.e. Sangster, 1993; Pike, 1996; Arnold and Hatzopoulos, 2000; Dhanani, 2005; Beatty *et al.*, 2006). Interestingly, field research in the Middle East has been non-existent. To the best of our knowledge, none of the financial survey focuses on emerging markets' firms, particularly in Kuwait; little has been found or published. Table I summarizes some of the main surveys in the finance literature.

The significant body of literature applies field research to confront theory with the practice of financial managers in developed countries, particularly the USA and the UK. However, these studies typically center on only one particular issue of corporate finance. For example, Gitman and Forrester (1977), Stanley and Block (1984), Sangster (1993), Pike (1996), Arnold and Hatzopoulos (2000) specifically focus on capital budgeting practices in developed countries such as the USA and the UK. Along with the area of capital budgeting, some studies include the cost of capital such as Epps and Mitchem (1994), Jog and Srivastava (1995), Billingsley and Smith (1996), Bruner *et al.* (1998), Block (1999), Black *et al.* (2002), and Troung *et al.* (2006). Furthermore, there have been some comparative studies including



Table I Summary of finance survey studies in the literature

<i>Authors</i>	<i>Firms</i>	<i>Response rate (%)</i>	<i>Country</i>	<i>Topics covered</i>
Lintner (1956)	28	4.70	USA	Dividend policy
Gitman and Forrester (1977)	103	38.40	USA	Capital budgeting
Gitman and Mercurio (1982)	87	25.70	USA	Cost of capital
Stanley and Block (1984)	121	36.70	USA	Capital budgeting
Sangster (1993)	94	19.15	UK	Capital budgeting
Epps and Mitchem (1994)	111	27.80	USA	Capital budgeting Cost of capital
Poterba and Summers (1995)	160	16.00	USA	Capital budgeting Capital structure
Jog and Srivastava (1995)	133	22.90	Canada	Capital budgeting Cost of capital
Billingsley and Smith (1996)	88	36.20	USA	Cost of capital Capital budgeting
Pike (1996)	99	78.10	UK	Capital budgeting
Bruner <i>et al.</i> (1998)	135	32.00	USA	Cost of capital Capital budgeting
Kester <i>et al.</i> (1999)	226	16.30	Asia-Pacific	Capital budgeting
Block (1999)	297	33.70	USA	Cost of capital Capital budgeting
Baker and Powell (2000)	185	30.68	USA	Dividend policy
Fan and So (2000)	259	46.17	Hong Kong	Capital structure
Arnold and Hatzopoulos (2000)	149	49.00	UK	Capital budgeting
Baker <i>et al.</i> (2001)	180	29.36	USA	Dividend policy
Graham and Harvey (2001)	392	9.00	USA	Capital budgeting Cost of capital Capital structure
Black <i>et al.</i> (2002)	136	28.00	New Zealand	Capital budgeting Cost of capital
Bancel and Mittoo (2002)	87	12.00	European Union Norway Switzerland	Capital structure
Anand (2002)	81	15.43	India	Capital structure Cost of capital Capital budgeting
Brounen <i>et al.</i> (2004)	313	5.00	The Netherlands Germany UK	Dividend policy Capital structure Cost of capital Capital budgeting
Brav <i>et al.</i> (2005)	384	16.00	France USA	Corporate governance Dividend policy
Dhanani (2005)	164	16.40	UK	Dividend policy
Truong <i>et al.</i> (2006)	87	28.00	Australia	Cost of capital Capital budgeting
Beattie <i>et al.</i> (2006)	192	23.00	UK	Capital structure

Kester *et al.* (1999), who explored capital budgeting techniques in Australia, Hong Kong, Indonesia, Malaysia, Philippines, and Singapore.

Bancel and Mittoo (2002) explored capital structure practices in the European Union, whereas Beatty *et al.* (2006) explored capital structure decisions in the UK. Fan and So (2000) also conducted a field study to explore capital structure in Hong Kong. Poterba and Summers (1995) explored both areas of capital structure and capital budgeting in the USA.

There was a field study of dividend policy started by Lintner (1956) in the USA. In addition, Baker and Powell (2000), Baker *et al.* (2001), Brav *et al.* (2005), Dhanani (2005) also explored dividend policy in the USA and the UK.

However, only very few studies implemented comprehensive financial policy surveys that cover many issues of corporate finance practices. The best-known survey is a comprehensive survey by Graham and Harvey (2001) focusing on capital structure, capital budgeting, and cost of capital among 392 CFOs in the USA. It is interesting to note



that Brav *et al.* (2005) conducted field research to explore dividend policy in the USA. Also, Anand (2002) surveyed 81 CFOs in India to explore capital budgeting, cost of capital, capital structure and dividend policy decisions. Two years later, Brounen *et al.* (2004) presented results of an international survey among 313 CFOs on capital budgeting, cost of capital, capital structure and corporate governance in the UK, The Netherlands, Germany and France.

While there are clear limitations of the literature review, the international trend is towards increased emphasis on advanced markets such as the USA, the UK, NZ, Europe and others. Nevertheless, to the best of our knowledge, the emerging markets in general and Kuwait in particular have never been conducted. This study extends the comprehensively cover of the four major areas of corporate finance.

Agency costs represent an important problem in corporate governance (Jensen and Meckling, 1976). Finance studies reveal that managers as agents of shareholders may not always act in the best interest of the shareholders. Donaldson (1984), for instance, concludes that the primary objective of corporate managers is to maximize the corporate wealth rather than shareholder's wealth. Brealey and Meyers (2000) argue that managers must not act on behalf of shareholders, but should pursue actions that are optimal for stakeholders. Brounen *et al.* (2004) find that all European firms aim to maximize their profits, have sustainable growth and market position. On the other hand, while leverage optimization and dividend maximization are the lowest priorities, shareholder wealth maximization is distinctive and prominent. Overall, the majority of these studies reveal that managers' corporate objectives vary substantially across countries. In order to investigate the good intention of managers' activity toward their shareholders, this study contains two questions: one question considers the primary objectives of corporate management whereas the second question explores the importance of stakeholders in the listed firms in Kuwait.

3. Methodology

Based on a comprehensive review of existing literature, a survey was developed to incorporate this important research question. The survey focuses primarily on the current corporate finance practices implemented by CFOs in listed companies in Kuwait. The target respondents are listed firms in the Kuwaiti Stock Exchange (KSE). The survey includes questions on topics that are closely related to capital budgeting, capital structure, cost of capital and dividend policy. For example, the survey asks the managers on how they estimate their cost of equity (CAPM or other methods) and whether the impact of the weighted average cost of equity is taken into consideration in their capital structure choices.

The survey contains 25 numbered questions in total. These questions, with few exceptions, are of "closed-end type" for easier and more efficient data organization and processing. The starting point of the questionnaire is based on the survey by Graham and Harvey (2001). To facilitate comparison, we ask questions similar to their survey concerning the questions about capital budgeting techniques, the characteristics of the firm and its CFOs and, the firm's target debt range. Additionally, we ask questions similar to the survey in Brounen *et al.* (2004) on corporate goals and the importance of stakeholders. The remaining questions that explore the capital structure mix, cost of capital and dividend policy are relatively similar to the survey in Anand (2002). Further, we have modified some questions to fit the Kuwaiti context. For example, we have omitted questions on bonds option, as there is no bond market there.

A total of 80 surveys were completed from managers in all the sectors by the end of June 2008 (a response rate of 53 percent). Given the length of the survey (five pages) and depth (25 questions) of our survey, this response rate compared favourably with other academic surveys[3].



4. Firm characteristics

Figure 1 presents summary information on the characteristics of the listed firms in the sample. The companies range from very small (7.5 percent of the sample firms have sales less than \$34) to very large (1.2 percent have sales of at least \$1,000 billion). Following Graham and Harvey (2001), we refer to firms with revenues of at least \$1 billion as “large”. Within the financial sector, around 34 percent of firms are investments, 10 percent of firms are banks, and around 4 percent are insurance firms. Within the non-financial sector, 19 percent of the firms are industry, 15 percent are real estate, and, only 5 percent are food firms (see Figure 2)[4].

The next component of our summary statistic concerns the CFOs' background, which is presented in Figure 3. Nearly 34 percent of CFOs are between the ages of 52 and 57 (Figure 4), a group we refer to as “mature”. An additional group of 36.3 percent are between the ages of 46 and 51 and another 16.3 percent are between the ages of 40 and 46. Around 63 percent of CFOs have undergraduate degree (bachelor) as their highest level of educational achievement (Figure 4). Another 19 percent have an MBA degree while 9 percent have a doctorate degree. The survey reveals that executives do not change jobs frequently.

Based on the results presented in Table II, non-financial sectors (such as service, industry, and food) would have higher chance of being privately owned, have larger sales revenues, and exhibit higher proportion of management ownership than financial sectors. Privately

Figure 1 Sales revenues (\$ millions)

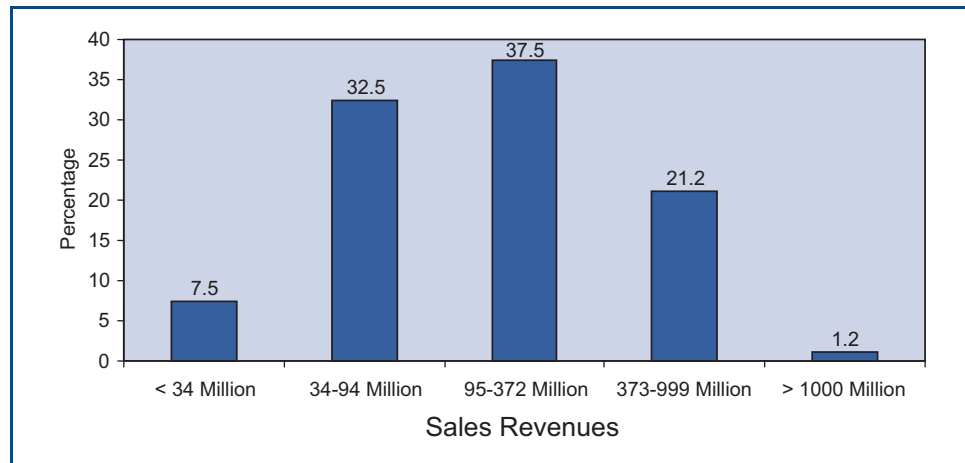


Figure 2 Sectors in Kuwait Stock Market

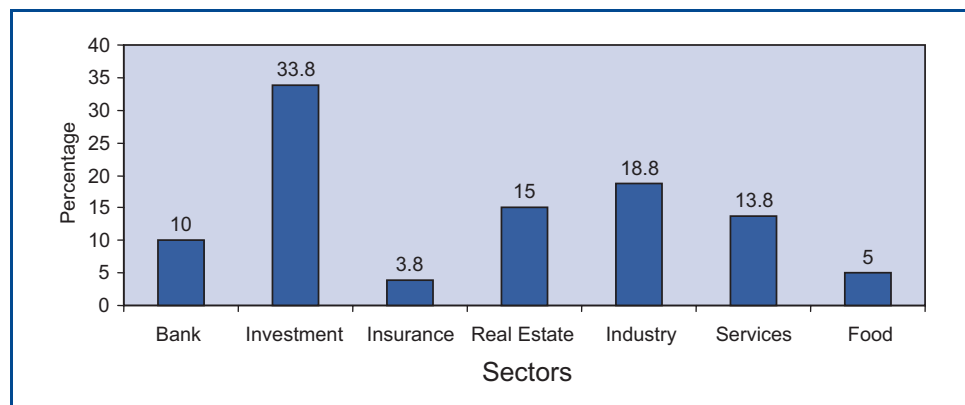


Figure 3 CEO Characteristics – CFOs' age

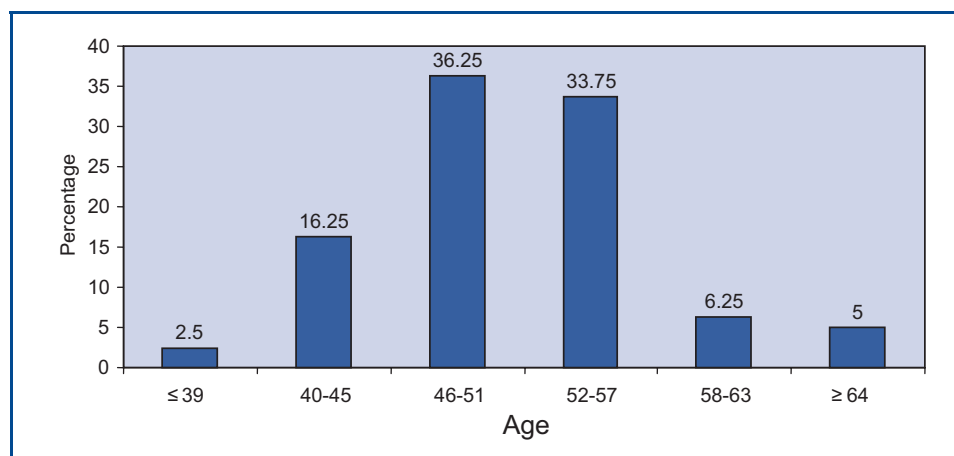


Figure 4 CEO Characteristics – CFOs' level of education

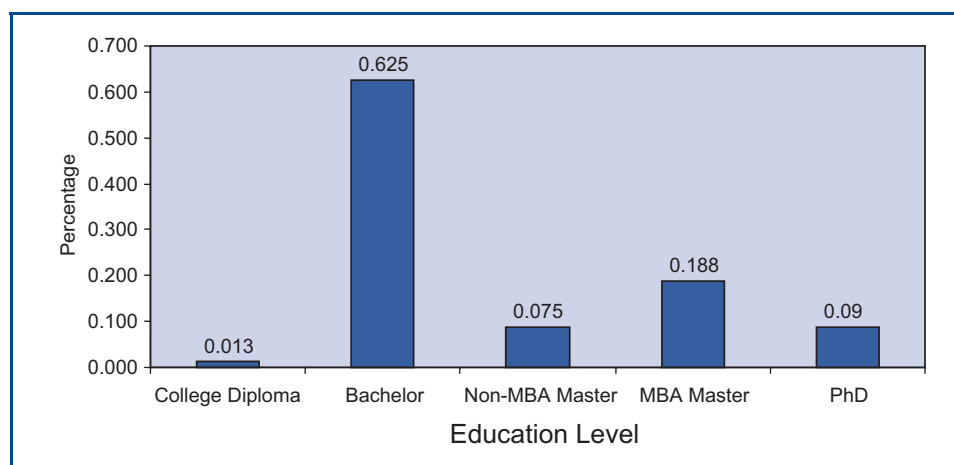


Table II Demographic correlations of control variables

	<i>Firm's sector</i> (bank to food)	<i>Equity</i> (public to private)	<i>Size</i> (very small to very large)	<i>CFO ownership</i> (low to very high)	<i>Education</i> (MBA to others)	<i>Tenure</i> (short to long)	<i>Age</i> (young to mature)	<i>Target debt ratio</i> (no to yes)
Firm's Sector	1							
Equity	0.430**	1						
Size	0.672**	0.323	1					
CFO								
Ownership	0.528*	0.339*	0.527**	1				
Education	0.442	0.326**	0.397	0.286	1			
Tenure	0.356	0.015	0.310	0.393*	0.140	1		
Age	0.184	0.162	0.329*	0.237	0.130	0.282*	1	
Target Debt Ratio	0.228	0.052	0.144	0.061	0.085	0.169	0.301**	1

Notes: * $p < 0.05$; ** $p < 0.01$; Mean square contingency coefficients were calculated for each of the variables in the study

owned firms have a higher proportion of CFO ownership and educated CFOs. Larger firms are likely to have a higher proportion of management ownership and older CFOs. In addition, a much higher proportion of management ownership has stronger association with tenure (term of the service) and, in turn, longer tenure contract increases with the age of the CFO, and, mature CFOs tend to use higher target debt ratios.

5. Survey results

5.1 Primary objective of corporate management

Regarding corporate governance, Table III reports the results of the survey, and, shows that Kuwaiti firms aim at:

- maximizing profits (100 percent of respondents);
- maximizing sustainable growth (100 percent);
- maintaining market position and service (97.5 percent);
- controlling cost, productivity and efficiency (97.5 percent);
- maintaining continuity (100 percent); and
- maximizing shareholder wealth (92.5 percent).

In contrast, dividend and leverage objectives are associated with lower priorities, with 70 percent and 71.2 percent of respondents regarding them as very important or important. It is also interesting to note that nearly 5 percent of the CFOs regard other corporate objectives as very important, including corporate image, expansion of the corporate service and product diversification. Our findings are similar to firms in the UK and The Netherlands (Brounen *et al.*, 2004).

In order to extend our analysis on the issue of corporate governance, we asked an additional question regarding the importance of stakeholders. Table IV presents our survey findings in regard to the importance of stakeholders to Kuwaiti firms. Almost 99 percent of CFOs

Table III Survey responses for the question, “Which of the following primary corporate objectives were important for your firm?”

<i>Primary objectives of corporate management</i>	<i>Very important/important (%)</i>
To maximize profits	100
To maximize sustainable growth	100
To maintain the market position and service quality	97.5
to control cost, productivity and efficiency	97.5
To maintain continuity	100
To maximize shareholder wealth	92.5
To maximize dividends	70
to optimize leverage	71.2
Other specified objectives	5

Table IV Survey responses for the question, “How important were the following stakeholders to your firm?”

<i>Stakeholders</i>	<i>Very important/important</i>
Customers	89
Employees	92.5
Management	98.7
Shareholders	93.8
Suppliers of goods/services	41.2
Suppliers of debt	53.8
Government	93.7



consider management as important or very important, followed by nearly 94 percent who consider government and shareholders as important or very important; whereas 93 percent regard employees as important or very important. While 89 percent of the surveyed CFOs consider customers important or very important, only 54 percent and 41.2 percent consider suppliers of goods and services and debt as important. As we expected, given that our sample contains only publicly listed firms, this may explain the high scores on management, government and shareholders. This particular finding is inconsistent with firms in Europe, as in Brounen *et al.* (2004), where customers are regarded as top priority.

Further on corporate governance, we also asked a question regarding the top three financial manager's ownership of common stocks. Figure 5 depicted that 78 percent of top managers hold less, or equal to 4 percent of shares, followed by 15 percent of top CFOs who hold from 5 percent to 9 percent of common shares; whereas only 2.5 percent hold greater or equal to 20 percent of shares. This result is consistent with the European and US samples where the majority of the firms' executives own less than 5 percent of shares.

5.2 Capital budgeting

Tables V-VII report the survey results on capital budgeting techniques used for decision making. The response that had the highest average score when asked was, "how frequently did your firm use the following capital budgeting techniques when deciding which projects or acquisitions to pursue" with an IRR of 97.4 percent, followed by NPV (96.3 percent). Non-DCF methods (such as Accounting Rate of Return (ARR) and PB) are less popular among listed firms in Kuwait. The pay back method is also popular (53.8 percent). Only 42.5

Figure 5 Top Three CFOs' Percentage of Common Stock

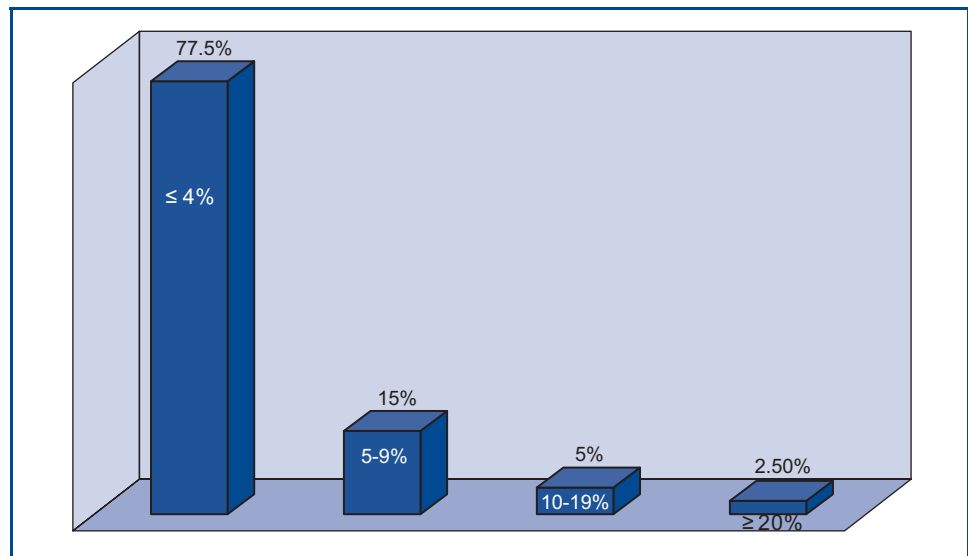


Table V Survey responses for the question, "How frequently did your firm use the following capital budgeting techniques when deciding which projects or acquisitions to pursue?"

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. NPV	96.3	4.59	4.875	4.74	5	4.33**	4.6	4.45	3.75*
2. ARR	42.5	3.00	4	2.89**	3.67	2.17*	3.13	2.73**	4
3. Payback	53.8	3.32	3.5	3.19	3.67	3.25	3.53	3.45	2.75
4. IRR	97.4	4.73	4.5	4.93**	4.67	4.58	4.73	4.82	4

Notes: * $p < 0.01$, ** $p < 0.05$



Table VI Survey responses for the question, “How frequently did your firm use the following capital budgeting techniques when deciding which projects or acquisitions to pursue?”

	% (Always or almost)	Equity				Size			Very large	CFO ownership			Very high
		M	Private	Both	Very small	Small	Medium	Large		Low	Medium	High	
1. NPV	96.3	4.59	4.59	4.57	4.17	4.5	4.6	4.82	5	4.53	4.75	4.75	4.5
2. ARR	42.5	3.00	2.89	3.5	3.5	2.80	2.7*	3.53	5	3.02	3.08	2.75	2.5
3. Payback	53.8	3.32	3.20	3.93*	3	3.27	3.13	3.82	4	3.27	3.5	3.5	3.5
4. IRR	97.4	4.73	4.73	4.71	4.17	4.73	4.83	4.71	5	4.76	4.67	4.5	4.5

Note: * $p < 0.05$ **Table VII** Survey responses for the question, “How frequently did your firm use the following capital budgeting techniques when deciding which projects or acquisitions to pursue?”

	%	MBA	Education			Short	Tenure			Age		TDR	
			PhD	Other	Medium		Long	Young	Mature	No	Yes		
1. NPV	96.3	4.59	4.82	4.71	4.478*	4.45	4.56	4.71	4.56	4.78	4	4.59	
2. ARR	42.5	3.00	3.14	4	2.80*	3.55	2.96	2.83	3.04	2.67	3	3	
3. Payback	53.8	3.32	3.5	4.14	3.12*	4	3.18**	3.29	3.25	3.89	5	3.30	
4. IRR	97.4	4.73	4.73	4.86	4.71	4.91	4.71	4.67	4.72	4.78	4	4.73	

Notes: * $p < 0.05$, ** $p < 0.10$

percent of the respondents use ARR as the most popular capital budgeting tools. The payback criterion is more popular among privately and publicly owned companies that are managed by CFOs with non-MBA with medium tenure. Overall, our results regarding capital budgeting are similar to those of Graham and Harvey (2001) for the North American studies, but differ from Brounen *et al.* (2004). Similar to the North American sample, the typical Kuwaiti CFO prefers the NPV and IRR techniques, in contrast to the European sample, that favor the payback period.

The response that had the highest average score when asked the question, “When valuing a project how did you assess your firm’s project risk?” was sensitivity analysis (mean = 3.71). The results in Tables VIII-X illustrate that sensitivity analysis, risk adjustment and scenario are the most widely used techniques for assessing project risk. Of the respondents, 73 percent use sensitivity analysis, 65 percent use risk adjustment, while 57 percent employs scenario analysis. Both sensitivity analysis and scenario analysis are significantly employed by insurance, real estate and food firms that are characterized by a high proportion of CFO ownership. Scenario analysis is significantly used by the industry sector (average = 2.67), whereas both sensitivity analysis and risk adjustment are used by the service sector to assess project risk. Scenario analysis is significantly used by CFOs without a MBA or PhD qualification. Additionally, mature CFOs are more likely to use scenario analysis, decision analysis and probabilistic analysis (Monte Carol simulation) than younger CFOs. Large firms

Table VIII Survey responses for the question, “When valuing a project how did you assess your firm’s project risk?”

	% (Always or almost)	Mean (M)	Firm’s sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. Sensitivity	72.6	3.71	4.25	4.22	2.33*	3.5***	3.73	3.27**	2*
2. Scenario	57.4	3.35	4.38	4.04	2.33**	2.5*	2.67*	3.64	1.75*
3. Decision	31.2	2.17	2.38	2.33	2	2.08	2	2.09	2
4. Probabilistic	11.2	2.19	3	2.44	1.33	1.92	2.13	1.64	2
5. Risk adjustment	65	3.52	4.13	3.70	4	2.58*	3.87	2.91**	4

Notes: * $p < 0.01$, ** $p < 0.05$, *** $p < 0.10$ 

Table IX Survey responses for the question, “When valuing a project how did you assess your firm’s project risk?”

	% (Always or almost)	Equity			Very small	Size			Very large	CFO ownership			Very high
		M	Private	Both		Small	Medium	Large		Low	Medium	High	
1. Sensitivity	72.6	3.71	3.73	3.64	2.83	3.19	4.13*	4**	5*	3.68	3.67	4.5**	3.5
2. Scenario	57.4	3.35	3.24	3.86	2.83	2.76	3.5*	4.06*	5*	3.21	3.67	4.5**	3.5
3. Decision	31.2	2.17	2.12	2.43	1.83	1.81	2.37	2.53**	2	2.16	2	2.75	2.5
4. Probabilistic	11.2	2.19	2.20	2.14	2.17	1.77	2.36*	2.35*	5*	2.16	2.17	2.5	2.5
5. Risk adjustment	65	3.52	3.62	3.07	3.17	3.31	3.63	3.76	4	3.47	3.67	4.25	3

Notes: * $p < 0.01$, ** $p < 0.05$ **Table X** Survey responses for the question, “When valuing a project how did you assess your firm’s project risk?”

	% (Always or almost)	M	Education			Tenure			Age		TDR	
			MBA	PhD	Other	Short	Medium	Long	Young	Mature	No	Yes
1. Sensitivity	72.6	3.71	4	3.71	3.59	4.09	3.6	3.75	3.65	4.22	4	3.71
2. Scenario	57.4	3.35	4.05	3.29	3.06*	3.8	3.18	3.46	3.211	4.44**	2	3.37
3. Decision	31.2	2.17	2.41	2	2.10	2.45	2.11	2.17	2.11	2.67**	3	2.16
4. Probabilistic	11.2	2.19	2.14	2	2.24	2.82	1.98*	2.29	2.11	2.78**	3	2.18
5. Risk adjustment	65	3.52	3.82	3.29	3.43	3.45	3.38	3.83	3.56	3.22	4	3.52

Notes: * $p < 0.01$, ** $p < 0.05$

are more likely to use sensitivity analysis, scenario analysis, decision analysis and probabilistic methods than smaller firms. Overall, our findings confront our expectations by highlighting an evidence-based approach among firms in Kuwait in applying DCF (IRR and NPV).

5.3 Cost of capital

Tables XI-XIII report the results of the survey on the methods used by Kuwaiti firms in the estimation of the cost of equity, and, shows that WACC is the most popular method (92.4 percent) of estimating the cost of equity capital, with dividend yield and earnings yield (86 percent) coming second. The third most popular method is CAPM (61.3 percent). Few firms use average historical returns on common stock (30 percent), “whatever our investor tell us” (12.4 percent), multifactor model (6.2 percent), and Gordon’s Dividend Discount Model (23.7 percent). Additionally, CAPM is the method of choice for medium and larger sized companies. On the other hand, the earnings yield method is preferred in the insurance sector (average score = 5), small, medium, and large firms as well as with CFOs with longer

Table XI Survey responses for the question, “How did you determine your firm’s cost of capital?”

	% (Always or almost [always])	Mean (M)	Firm’s sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. CAPM	61.3	3.45	4.5	4.37	4.33	2.25*	2.2*	3.27*	3.25**
2. Historical returns	30	2.55	3.63	2.85	3.33	2.83	1.8*	1.81*	1.75*
3. Investor	12.4	2.1	3	2.33	3.33	1.5*	1.67*	1.45*	3
4. Dividend	86.2	3.99	3.88	4.07	5	4.08	3.67	3.72	4.5
5. Earning	86.3	4.05	3.75	4.15	5**	4.42	3.67	3.73	4.5
6. Multi-factor	6.2	2.01	2.38	2.37	2.33	1.83	1.67	1.55	1.75
7. GDDM	23.7	2.29	3.5	2.78	2.33	1.67*	1.93*	1.55*	1.75**
8. WACC	92.4	4.49	4.25	4.41	4	4.92	4.47	4.55	4.5

Notes: * $p < 0.01$, ** $p < 0.05$

Table XII Survey responses for the question, “How did you determine your firm’s cost of capital?”

	% (Always or almost)	Equity				Size			CFO ownership				
		M	Private	Both	Very small	Small	Medium	Large	Very large	Low	Medium	High	Very high
1. CAPM	61.3	3.45	3.36	3.86	2.17	3	3.67*	4.18*	4	3.16	4.33**	4.75*	4.5
2. Historical returns	30	2.55	2.55	2.57	0.67	2.54*	2.433*	3.35*	4	2.5	2.83	2.25	3
3. Investor	12.4	2.1	2.05	2.36	1.33	1.92	2	2.77	3	1.95	2.75**	2	3
4. Dividend	86.2	3.99	4.02	3.86	2.83	4.19*	4.1*	3.88*	4	4.05	4.08	3**	3.5
5. Earning	86.3	4.05	4.09	3.86	2.83	4.27*	4.1*	4.06*	4	4.05	4.17	4	3.5
6. Multi-factor	6.2	2.013	2.03	1.93	1	1.77***	2.17*	2.47*	2	1.92	2.25	3**	1.5
7. GDDM	23.7	2.29	2.30	2.21	1	1.92**	2.47*	2.88*	4	2.15	3.08**	2	2.5
8. WACC	92.4	4.49	4.52	4.36	3.17	4.85	4.6	4.23	4	4.47	4.5	4.75	4.5

Notes: * $p < 0.01$, ** $p < 0.05$, *** $p < 0.10$

Table XIII Survey responses for the question, “How did you determine your firm’s cost of capital?”

	% (Always or almost)	Education				Tenure			Age			TDR	
		M	MBA	PhD	Other	Short	Medium	Long	Young	Mature	No	Yes	
1. CAPM	61.3	3.45	3.95	3.14	3.27	3.36	3.18	4	3.45	3.56	2	3.47	
2. Historical returns	30	2.55	2.63	2.14	2.57	2.90	2.49	2.5	2.54	2.67	1	2.57	
3. Investor	12.4	2.1	2.23	2.29	2.02	2.55	2.02	2.04	2.09	2.22	1	2.117	
4. Dividend	86.2	3.99	4.09	3.43	4.02	3.45	4.13	3.96	4.03	3.67	5	3.97	
5. Earning	86.3	4.05	4.23	3.43	4.06	3.36	4.16*	4.17*	4.014085	4.333333	5	4.037975	
6. Multi-factor	6.2	2.01	2.36	1.7	1.90	2.27	1.91	2.08	1.96	2.44	1	2.03	
7. GDDM	23.7	2.29	2.59	2.29	2.16	2.45	2.16	2.46	2.28	2.33	1	2.30	
8. WACC	92.4	4.49	4.64	3.86	4.51	4	4.62**	4.46	4.51	4.33	5	4.48	

Notes: * $p < 0.05$, ** $p < 0.10$

tenure. The dividend yield method is significantly used by small, medium and large firms as well as firms with a high proportion of CFO ownership.

Tables XIV-XVI report the survey results on the risk-free rate of return used by respondents who use the CAPM method. Nearly 44 percent of the respondents consider 90 day T-bill as a risk free rate (mean = 2.05). Only 16 percent use a three to seven year T-bill as a risk free rate, while very few use a ten year T-bill as a risk free rate (average = 3.7). All three rates of returns are significantly used by real estate, industry and large firms and are preferred by CFOs without a MBA or PhD qualification on a sliding scale. CFOs with medium and longer tenure are more likely to use 3-7 year T-bill as risk-free rate. Firms with higher proportions of CFO ownership are likely to use a 10 year T-bill ($M = 2.5$).

Tables XVII-XIX show the survey results on how beta is estimated by respondents who utilise the CAPM. Nearly 49 percent of the respondents take beta from published sources as a measure of the systematic risk. Industry average beta is the second most popular measure (39 percent), while the third and fourth popular sources are self-calculated (15 percent) and

Table XIV Survey responses for the question, “What did you use for risk-free rate?”

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. 90 day T-bill	43.8	2.05	3.375	3.59	0*	0.17*	0.8*	2.36	0*
2. 3-7 year T-bill	16.2	1.14	2.375	2	0*	0.17*	0.4*	0.90	0*
3. 10 year T-bill	3.7	1.05	1.375	2.07	0*	0.08*	0.53*	0.73	0*

Note: * $p < 0.01$



Table XV Survey responses for the question, “What did you use for risk-free rate?”

	% (Always or almost)	Equity			Very small	Size			Very large	CFO ownership			Very high
		M	Private	Both		Small	Medium	Large		Low	Medium	High	
1. 90 day T-bill	43.8	2.05	1.77	3.36*	0	1.19*	2.7*	2.82*	4	1.76	3***	3.5	2.5
2. 3-7 year T-bill	16.2	1.14	1.05	1.57	0	0.5	1.53*	1.82*	1	1.10	1.33	1.25	1
3. 10 year T-bill	3.7	1.05	1	1.29	0	0.62	1.37*	1.53*	1	0.95	1.08	2.5**	1

Note: * $p < 0.01$, ** $p < 0.05$, *** $p < 0.10$

Table XVI Survey responses for the question, “What did you use for risk-free rate?”

	% (Always or almost)	M	Education				Short	Tenure		Long	Age		TDR	
			MBA	PhD	Other	Medium		Long	Young		Mature	No	Yes	
1. 90 day T-bill	43.8	2.05	2.95	1.71	1.71**	2	1.76	2.63	2.18	1	0	2.08		
2. 3-7 year T-bill	16.2	1.14	1.86	0.863	0.86*	2.09	0.8*	1.33***	1.21	0.56	0	1.15		
3. 10 year T-bill	3.7	1.05	1.68	0.86	0.80*	1.54	0.78***	1.33	1.08	0.78	0	1.06		

Notes: * $p < 0.01$, ** $p < 0.05$, *** $p < 0.10$

Table XVII Survey responses for the question, “What did you use as your volatility or beta factor?”

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. CFO	10	1.19	2.13	1.89	0*	0.33*	0.4*	1.55	0*
2. Self estimate	15	1.37	2.88	2.48	0*	0.17*	0.53*	0.91*	0*
3. Industry average	38.7	1.97	4	3.15	0*	0.33*	0.73*	2.36	0*
4. Published source	48.7	2.35	4.25	3.81	0*	0.42*	0.93*	2.90	0*

Note: * $p < 0.01$

Table XVIII Survey responses for the question, “What did you use as your volatility or beta factor?”

	% (Always or almost)	Equity			Very small	Size			Very large	CFO ownership			Very high
		M	Private	Both		Small	Medium	Large		Low	Medium	High	
1. CFO	10	1.19	0.90	2.5*	0	0.58	1.4**	2.12*	2	1.097	1.58	1.5	1
2. Self estimate	15	1.37	1.28	1.93	0	0.65	1.77*	2.18*	3	1.21	1.75	3**	1
3. Industry average	38.7	1.97	1.70	3.29*	0	1.08**	2.43*	3.12*	4	1.73	2.5	4.25**	2
4. Published source	48.7	2.35	2.06	3.71**	0	1.46**	2.97*	3.35*	4	2.02	3.33	4.5**	2.5

Notes: * $p < 0.01$, ** $p < 0.05$

Table XIX Survey responses for the question, “What did you use as your volatility or beta factor?”

	% (Always or almost)	M	Education				Short	Tenure		Long	Age		TDR	
			MBA	PhD	Other	Medium		Long	Young		Mature	No	Yes	
1. CFO	10	1.19	2.09	1.43	0.76*	1.82	1.02***	1.21	1.27	0.56	0	1.20		
2. Self estimate	15	1.37	2.14	1	1.09**	2.27	1.13**	1.42	1.41	1.11	0	1.39		
3. Industry average	38.7	1.97	3.32	1.29**	1.49*	2.55	1.44	2.71	2.06	1.33	0	2		
4. Published source	48.7	2.35	3.82	1.43*	1.84*	2.45	1.96	3.04	2.48	1.33	0	2.38		

Notes: * $p < 0.01$, ** $p < 0.05$, *** $p < 0.10$



the CFO's estimate (10 percent). Larger firms, firms in real estate and industry sectors are more inclined to use all these four popular sources to measure their systematic risk than smaller firms and by CFOs without a MBA or PhD qualification. Small firms use an industry average and published sources (mean = 1.077 and 1.462, respectively). Self-calculated, industry average and published sources are used significantly in medium and large firms where higher proportion of management ownership exists. Furthermore, industry average and published sources are used significantly by firms of all sizes, both privately and publicly owned, and, by firms with a higher proportion of CFO ownership.

We also ask the respondents who use the CAPM to indicate what sample period they use to calculate beta, the results of which are presented in Tables XX-XXII. Nearly 42 percent of the respondents rely on monthly share price data to estimate equity beta, while approximately 29 percent of respondents use weekly share price data. The use of weekly and monthly share price data to estimate security beta is significantly more popular among small, medium and large firms, firms with higher management ownership, both public and private firms, CFOs with PhDs and other qualifications, and real estate, industry and service sectors. The use of monthly share price data to estimate security beta is significantly more popular among CFOs with longer tenure.

Tables XXIII-XXV report the survey results on what market premium are used in the CAPM model by CAPM users. The average market risk premium of 6 to 8 percent is most widely used by Kuwaiti firms. It is followed by CFO's estimate of average market risk premium as an input, while using CAPM (15 percent). About 13 percent of respondents use an 8 to 9 percent fixed rate as a market risk-premium in the CAPM model. These three measurements are widely used among real estate, industry and service sectors, medium and larger sales revenue firms, both publicly and privately owned companies, and, firms managed by CFOs without a MBA or PhD qualification. In addition, firms with a higher proportion of CFO

Table XX Survey responses for the question, "What period did you study to calculate beta of your firm?"

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. Weekly	28.7	1.76	4.125	2.89**	0*	0.17*	0.67*	1.64*	0*
2. Monthly	42.4	2.14	4.125	3.44	0*	0.17*	0.87*	2.73***	0*

Notes: * $p < 0.01$, ** $p < 0.05$, *** $p < 0.10$

Table XXI Survey responses for the question, "What period did you study to calculate beta of your firm?"

	% (Always or almost)	M	Equity			Size			CFO ownership				
			Private	Both	Very small	Small	Medium	Large	Very large	Low	Medium	High	Very High
1. Weekly	28.7	1.76	1.55	2.79**	0	1.077**	1.97*	2.94*	4	1.56	2.17	4**	1
2. Monthly	42.4	2.14	1.89	3.29**	0	1.31**	2.63*	3.18*	4	1.89	2.58	4.5**	2.5

Notes: * $p < 0.01$, ** $p < 0.05$

Table XXII Survey responses for the question, "What period did you study to calculate beta of your firm?"

	% (Always or almost)	M	Education			Tenure			Age			TDR	
			MBA	PhD	Other	Short	Medium	Long	Young	Mature	No	Yes	
1. Weekly	28.7	1.76	3.09	0.714286*	1.33*	2.090909	1.56	2	1.80	1.44	0	1.78	
2. Monthly	42.4	2.14	3.64	1*	1.65*	2.272727	1.76	2.79**	2.23	1.44	0	2.17	

Notes: * $p < 0.01$, ** $p < 0.10$



Table XXIII Survey responses for the question, “What did you use as measurement for market risk premium in a CAPM model?”

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. Fixed rate (6% to 8%)	42.4	2.19	3.88	3.48	0*	0.33*	0.87*	3	0*
2. Fixed rate (8% to 9%)	12.5	1.11	2.63	1.85**	0*	0.17*	0.33*	1*	0*
3. CFO estimate	15	1.30	3.13	2.11**	0*	0.33*	0.2*	1.36*	0*

Notes: * $p < .01$; ** $p < 0.05$ **Table XXIV** Survey responses for the question, “What did you use as measurement for market risk premium in a CAPM model?”

	% (Always or almost)	M	Equity			Very small	Size			Very large	CFO ownership			Very high
			Private	Both	Small		Medium	Large	Low		Medium	High		
1. Fixed rate (6% to 8%)	42.4	2.19	1.92	3.43**	0	1.42*	2.6*	3.24*	5	1.82	3.25**	4.5**	2	
2. Fixed rate (8% to 9%)	12.5	1.11	0.94	1.931*	0	0.54	1.23*	2.12*	2	0.94	1.42	3**	1	
3. CFO estimate	15	1.30	1.05	2.5*	0	0.5	1.53*	2.41*	4	1.16	1.83	2.25	0.5	

Notes: * $p < 0.01$, ** $p < 0.05$ **Table XXV** Survey responses for the question, “What did you use as measurement for market risk premium in a CAPM model?”

	% (Always or almost)	M	Education				Tenure			Age		TDR	
			MBA	PhD	Other	Short	Medium	Long	Young	Mature	No	Yes	
1. Fixed rate (6% to 8%)	42.4	2.19	3.59	1.57**	1.67*	2.27	1.76	2.96	2.25	1.67	0	2.23	
2. Fixed rate (8% to 9%)	12.5	1.11	1.86	1	0.80*	1.72	0.87**	1.29	1.14	0.89	0	1.13	
3. CFO estimate	15	1.30	2.14	1.43	0.92*	2.09	1.02**	1.46	1.37	0.78	0	1.32	

Notes: * $p < 0.01$, ** $p < 0.05$

ownership prefer the average market risk premium of 6 to 8 percent. A fixed rate of between 8 and 9 percent is used predominantly by firms with high management ownership. The average market risk premium of 6 to 8 percent is most widely used by small firms, medium management ownership, and, CFOs with a PhD.

We then explore the tax rate used to calculate after-tax cost of debt as well as the weights used in the computation of weighted average cost of capital (“WACC”) of the firm. Tables XXVI-XXVIII present the survey responses. The minimum alternative tax (or *zakat*)[5] is widely used for calculating after-tax cost of debt. Nearly 95 percent of the respondents use the *zakat*, while 90 percent of the respondents also use the current statutory tax rate (mean = 4.60 and 4.41, respectively). Kuwaiti firms use all possible weights in the computation of WACC. These weights are based on book and market values of the firm as well as target capital structure. The market value weights are widely used (44 percent) followed by target capital structure weights (26.3 percent). Only 11.3 percent of the respondents use book value weights. A few of the respondents use more than one basis to estimate the WACC. The investment and the insurance sectors, CFOs with medium tenure and firms with target debt ratio are significantly more likely to use *zakat* and the current statutory tax rate for estimating the after-tax cost of debt.



Table XXVI Survey responses for the question, “What tax rate was used to calculate after tax cost of debt and the weights you use in the computation of weighted average cost of capital ‘WACC’ of the firm?”

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. Current statutory	90	4.41	4.5	4.19*	3.67	4.5	4.4	4.82	5
2. Minimum alternative	95	4.60	4.88	4.41	4.67*	4.5	4.6	4.82	5
3. Book value	11.3	2.40	2.13	2.44	3.33*	2.75	2.47	1.82	2.25
4. Market value	43.8	3.12	3	3.22	3.33	2.25	3.93*	2.91	2.75
5. Target capital	26.3	2.60	2.5	2.96	3	2.42	2.27	2.09	3.25

Note: * $p < 0.10$

Table XXVII Survey responses for the question, “What tax rate was used to calculate after tax cost of debt and the weights you use in the computation of weighted average cost of capital ‘WACC’ of the firm?”

	% (Always or almost)	Equity			Size				CFO ownership				
		M	Private	Both	Very small	Small	Medium	Large	Very large	Low	Medium	High	Very high
1. Current statutory	90	4.41	4.35	4.71	4.67	4.73	4.2	4.18	5	4.39	4.58	4	5
2. Minimum alternative	95	4.60	4.56	4.79	4.67	4.77	4.33	4.76	5	4.52	4.83	5	5
3. Book value	11.3	2.40	2.47	2.07	1.83	2.65	2.37	2.24	3	2.44	2.67	1.25*	2
4. Market value	43.8	3.12	3.21	2.71	3	3.077	3.23	3	4	3.08	3.33	3.75	2
5. Target capital	26.3	2.60	2.68	2.21	2.67	2.54	2.47	2.82	4	2.58	2.58	3.25	2

Note: * $p < 0.05$

Table XXVIII Survey responses for the question, “What tax rate was used to calculate after tax cost of debt and the weights you use in the computation of weighted average cost of capital ‘WACC’ of the firm?”

	% (Always or almost)	M	Education			Tenure			Age		TDR	
			MBA	PhD	Other	Short	Medium	Long	Young	Mature	No	Yes
1. Current statutory	90	4.41	4.32	5	4.37	3.82	4.58**	4.38	4.45	4.11	2	4.44**
2. Minimum alternative	95	4.60	4.73	5	4.49	4.09	4.62**	4.79*	4.58	4.78	4	4.61
3. Book value	11.3	2.40	2.18	1.86	2.57	2.73	2.35	2.33	2.44	2.11	2	2.41
4. Market value	43.8	3.12	2.81	3	3.27	3.18	2.93	3.46	3.04	3.78***	5	3.10
5. Target capital	26.3	2.60	2.86	2.43	2.51	2.73	2.38	2.96	2.55	3	2	2.61

Notes: * $p < 0.01$, ** $p < 0.05$, *** $p < 0.10$

In summary, Kuwaiti firms rely on CAPM for estimating the cost of equity capital whereas WACC is the most favoured cost of the capital model. Among CAPM users, the T-bill is used as a proxy for the risk-free rate; beta comes from published sources as a measure of systematic risk; and, a market risk premium between 6 to 8 percent is commonly used as an input in the CAPM model. Though our results are consistent with existing literature, we raise an important distinction on the tax rate used in estimating WACC by Kuwaiti firms. Since Kuwait offers a unique environment due to the simplicity of its tax regime, we found that managers who apply CAPM to estimate their cost of capital tend to use the minimum alternative tax (or *zakat*), while the current statutory tax rate is widely used for calculating after-tax cost of debt.

5.4 Capital structure

The results in Tables XXIX-XXXI indicate the sources of financing choices and rank them in order of their relative importance in terms of its use. The results in this table indicate that retained earnings are the most favoured source of finance among Kuwaiti firms. Nearly 95



Table XXIX Survey responses for the question, “What were the sources of finance you choose when funding your firm’s project?”

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. Loans	91.3	4.50	3.75	4.48**	4.33	5*	4.67*	4.55**	4
2. Earnings	95	4.39	3.75	4.37**	4.67*	4.08	4.8*	4.45**	4.75**
3. Stock	83.8	3.95	3.875	3.78	4.33	4.25	4.2	3.82	3.5

Notes: * $p < 0.01$, ** $p < 0.05$

Table XXX Survey responses for the question, “What were the sources of finance you choose when funding your firm’s project?”

	% (Always or almost)	Equity			Size				CFO ownership				
		M	Private	Both	Very small	Small	Medium	Large	Very large	Low	Medium	High	Very high
1. Loans	91.3	4.50	4.62	3.923*	4.33	4.73	4.57	4.06	5	4.55	4.33	4	5
2. Earnings	95	4.39	4.42	4.2	4.83	4.46	4.47	4	4	4.45	4.33	3.75**	4
3. Stock	83.8	3.95	3.98	3.79	4	4	4	3.71	5	3.90	4.25	3.75	4

Notes: * $p < 0.01$, ** $p < 0.05$

Table XXXI Survey responses for the question, “What were the sources of finance you choose when funding your firm’s project?”

	% (Always or almost)	M	Education			Tenure			Age		TDR	
			MBA	PhD	Other	Short	Medium	Long	Young	Mature	No	Yes
1. Loans	91.3	4.50	4.41	4	4.61	4.36	4.6	4.38	4.46	4.78	4	4.51
2. Earnings	95	4.39	4.05	4.71**	4.49*	4.27	4.49	4.25	4.38	4.44	5	4.38
3. Stock	83.8	3.95	3.77	4.29	3.98	3.90	4	3.88	3.96	3.89	4	3.95

Notes: * $p < 0.01$, ** $p < 0.05$

percent of the respondents consider it very important or an important source of finance. Retained earnings are significantly used by investment, insurance, industry, service and food sectors, and, those firms that are managed by CFOs with higher portion of ownership and CFOs with a PhD or other qualification. Loans from financial institutions are the next most widely used source of finance. of the respondents, 90 percent have indicated that loans from financial institutions as the most important or important source of finance. Firms in the investments, real estate, industry, service and both privately and publicly owned companies are significantly more likely to opt for loans. The issue of equity capital stock as a source of finance is one of the most preferred by the respondents (mean = 3.95). Nearly 84 percent of the respondents consider it as the most preferred or preferred source of finance. There is no significant difference in the use of equity capital stock between firms classified based on firm size, equity, sector and CFO's characteristics. Interestingly, this finding contradicts our expectations because it does not reveal a strong evidence of pecking-order theory of capital structure among firms in Kuwait, but suggests that firms do not have any particular source of choices when it comes to how best to finance their projects.

5.5 Dividend Policy

The results in Tables XXXII-XXXIV indicate that 96.2 percent of the respondents strongly agree or agree that their dividend payout ratio affects the market value of the firm in the stock market. These respondents are firms from the industry and food sectors as well as private and public companies, and CFOs with a PhD or other qualification. Ninety percent of the respondents strongly agree or agree that investors generally prefer cash dividends today to uncertain



Table XXXII Survey responses for the question, “How far do you agree on the following decisions on why your firm pay dividends?”

	% (Always or almost)	Mean (M)	Firm's sector						
			Bank	Investment	Insurance	Real estate	Industry	Services	Food
1. Market value	96.2	4.51	4.25	4.44	4.67	4.58	4.67**	4.3	5*
2. Future prospects	88.5	4.05	3.875	3.85	4.33	4.08	4.2	4.18	4.5
3. Bonding mechanism	27.5	2.54	2.5	2.78	2.33	2.67	2.27	2.09	3
4. Investors	90	4.38	4	4.44	4.33	4.33	4.47	4.36	4.5

Notes: * $p < 0.05$, ** $p < 0.10$

Table XXXIII Survey responses for the question, “How far do you agree on the following decisions on why your firm pay dividends?”

	% (Always or almost)	Equity			Size				CFO ownership				
		M	Private	Both	Very small	Small	Medium	Large	Very large	Low	Medium	High	Very high
1. Market value	96.2	4.51	4.58	4.22*	4.83	4.54	4.53	4.29	5	4.55	4.33	4.5	4.5
2. Future prospects	88.5	4.05	4.03	4.14	4.17	4.12	3.93	4.12	4	4.03	3.92	4.5	4.5
3. Bonding mechanism	27.5	2.54	2.53	2.57	2.83	2.39	2.47	2.82	2	2.55	2.25	3	3
4. Investors	90	4.38	4.36	4.43	4.67	4.42	4.37	4.24	4	4.39	4.25	4.5	4.5

Note: * $p < 0.05$

Table XXXIV Survey responses for the question, “How far do you agree on the following decisions on why your firm pay dividends?”

	% (Always or almost)	M	Education			Tenure			Age		TDR	
			MBA	PhD	Other	Short	Medium	Long	Young	Mature	No	Yes
1. Market value	96.2	4.51	4.23	4.71**	4.61*	4.3	4.6	4.42	4.51	4.56	4	4.52
2. Future prospects	88.5	4.05	4.27	4	3.96	4	4	4.17	4.13	3.44**	3	4.06
3. Bonding mechanism	27.5	2.54	2.68	2.43	2.49	2.45	2.73	2.21	2.42	3.44**	3	2.53
4. Investors	90	4.38	4.27	3.86	4.49	4.45	4.42	4.25	4.38	4.33	4	4.38

Notes: * $p < 0.01$; ** $p < 0.05$

future price appreciation. Nearly eighty-nine percent of the respondents strongly agree or agree that dividends provide signalling mechanism of the future prospects for the firm. Only 27.5 percent of the respondents strongly agree or agree that dividend payments provide a bonding mechanism to encourage managers to act in the best interest of the shareholders.

6. Conclusion

The results of our survey on Kuwaiti corporate finance practices are generally consistent with existing studies. For example, NPV is widely used now as a capital budgeting techniques for decisions making today more than in previous times. The IRR remains popular despite its limitations. This finding is similar to firms in the USA and European context. Although the traditional one factor Capital Assets Pricing Model (CAPM) is also in use now to estimate the cost of equity capital, CAPM is relatively less employed in Kuwait than in North America and Europe. Because Kuwait is a tax free environment, WACC remains the most popularly used method in the estimation of the cost of capital.



A substantial number of Kuwaiti firms rarely use book value weights to compute their WACC, instead relying on all possible weights. These weights are based on the book value of the firm, market value of the firm and target capital structure. This practice is not in line with corporate finance theory. This implies that corporate practitioners may not apply the NPV or CAPM rule correctly, which is also the case among US and India managers (as in Graham and Harvey, 2001 and Anand, 2002 studies). In fact, most firms rely on the minimum alternative tax (or *zakat*), and, current statutory tax rate to determine their WACC due to the simplicity of the tax system in Kuwait.

In regards to dividend policy, Kuwaiti management agree that a cash dividend in hand today is more preferred than uncertain future price appreciation in such a tax-free environment. This affirms the “Bird-In-Hand” dividend theory. This interesting finding does not confirm with firms in North America and Europe context in which tax plays an important rule among firms and hence, investors do not favour dividend paying firms. This finding needs further research and investigation as it measures the belief of financial executives and not necessarily their actions.

In our analysis of preferred capital structure, our findings suggest that firms do not have any preference when it comes to how to best finance their projects. Interestingly, managements are much less likely to follow academically taught theories when determining capital structure. This finding may suggest that business schools are better in teaching capital budgeting, cost of capital and dividend policy than teaching capital structure theories. This finding is in line with Graham and Harvey (2001). Therefore, additional research is needed to further expand on these issues in deep details, separately.

The limitation of this study lies in the absence of empirical investigation on how the corporate finance decisions may affect firms’ performance in Kuwait. Hence, the empirical validation will be performed by the authors in the next stage of this research which will form the basis for further research.

Regarding the issue of corporate governance, we find that firms in Kuwait are striving towards maximizing profits. We also document that managers are regarded as a top priority among firms in Kuwait. This particular finding is conflicting with firms in Europe where customers are regarded as the most important stakeholder. This may indicate the existence of an agency problem in the case of Kuwait where managers may not always act in the best interest of shareholders. We also find that most of the top three executives in Kuwait hold less than 5 percent of common stocks, which is similar to US and European countries. Since ownership structure is one of the key mechanisms of corporate governance, it becomes essential to empirically investigate the impact of corporate governance mechanism on corporate performance. The empirical validation for corporate governance impact on performance will also be performed by the authors in the next stage of this research which will also form the basis for further research.

Notes

1. As evidenced from the developing countries, only one study is survey-based performed, as done by Anand (2002) in India. While a study by Omet and Mashharawe (2003) focuses only on the empirical analysis of capital structure determinants of non-financial companies in Jordanian, Saudi, Kuwaiti, and Omani markets, none of the research is devoted to studying the financial policies and practices in the Gulf region. Hence, the survey evidence from Kuwaiti firms on corporate finance practices is non-existent.
2. If CFOs were not available to fill out the survey, then CEOs usually did it. Therefore in our survey, CFOs also include CEOs.
3. Graham and Harvey (2001) obtained a 9 percent response rate in a survey mailed to 4,440 CFOs. Trahan and Gitman (1995) obtained a 12 percent response rate in a survey mailed to 700 CFOs. Brounen *et al.* (2004) obtained a 5 percent response rate in a survey mailed to 313 CFOs, and, Anand (2002) obtained a 15.43 percent response rate in a survey mailed to 500 CFOs.
4. In order to save space, the rest of the figures for firm and managers characteristics are not reported in this research.



5. Law No.46 of 2006 concerning Zakat and the contribution of Public and Closed Share holding Companies in the Kuwait state's budget has been issued on Nov 27, 2006. Accordingly, all Kuwaiti public and Closed Shareholding companies excluding government companies and foreign companies are liable to pay Zakat at the end of the financial year (December). Zakat is computed at 1 percent of annual net profit.

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Further reading

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