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Government Ownership Effect on Staffing Level and Financial Performance: A Case Study on Kuwaiti Banks

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Abstract

It has always been believed that government ownership would lead to overstaffing, inefficiency, and bad financial performance in any organization. This study aims to examine the effect of government ownership on staffing level and the financial performance of Kuwaiti bank over the period 2010-2018. Using panel OLS regression method based on the financial data of ten banks listed at Kuwait stock exchange (KSE), results showed that there was a statistically significant direct relation between government ownership and overstaffing and statistically significant inverse relation between government ownership and the financial performance of banks measured by return on assets (ROA). On the other hand, results showed that there was no relation between overstaffing and the financial performance of Kuwaiti banks. Results presented in this research shows the roll government ownership plays in inflating staff numbers in Kuwaiti banks for political rather than economic reasons and also the government influence on the decision making process in these banks resulting in lower financial performance.

Keywords: *Government Ownership; Kuwaiti Banks; Staffing level; Financial Performance; Panel OLS Analysis*

JEL Classifications: *C53; G32; M21*

Introduction

Government sectors has always been lagging behind the private sectors in terms of efficiency, productivity, and financial performance. The time government officials' need to deal with risks, opportunities, and changing market conditions is by far longer than that in private sector due to bureaucracy and long decision making layers. The ownership of government in banks, either complete or partial, would likely result in transferring some of the government management system culture into the way the bank operates. This imported government management culture would have an impact on the efficiency, productivity, and the financial performance of the bank. Governments own banks or shares in banks for different reasons, according to La Porta et al. (2002) there are two theoretical perspectives for government ownership in banks. The first one is the development theorists, which states that government ownership of banks facilitates allocation of credit to strategic and long-term socially desirable project that otherwise may not get private funding. The second one is the political theorists which suggests that government own banks to fund inefficient but politically desirable projects. None of these theories supports the ultimate goal of any business organization which is profitability and enhancing shareholders wealth. The reason for that is simply that government representatives in the bank board of directors do not own shares in the bank and their membership in the board was through appointing them by the government. This will make them focus more on what the government wants to do through their ownership in the bank and not what is in the best interest of the bank. Needless to say that at the end of the day those government representatives get their salaries from the government and not from the bank.

There are 10 Kuwaiti commercial banks operating in Kuwait where the government partially owns 8 of them with an ownership ranging from 5.01% to 48.05%. This ownership can work as a double blade sword, banks with higher government ownership would have more access to government funds and higher volume of government transactions would go through the bank. On the other hand, having these privileges come with cost, government would have a say on how the bank operates and might in some cases force unfeasible decisions that affects the overall performance of the bank.

This study aims to investigate the effects of government ownership on both the level of staffing and financial performance in Kuwaiti banks. Despite the large literature examining the effect of government ownership on the staffing level and financial performance in commercial banks. This research is the first, up to my knowledge, to examine these relations on Kuwaiti bank. To achieve the objective of this research, this study is structured as follows: introduction, literature review, methodology, empirical results, conclusion, and references.

Literature Review

There are many researches addressing the effect of government ownership on both staffing level and banks' financial performance. Cornett et al. (2010) conduct a cross-country analysis, using the data of five Asian countries, namely, Thailand, Indonesia, Philippines, South Korea and Malaysia. They concluded that government ownership is associated with poor performance. Wang (2018) also concluded that ownership-performance relation is negative for government ownership and positive for private ownership, and the difference between these relations is significant. Barako and Tower (2007) examined the effect of ownership structure in Kenyan banks on the financial performance of these banks and found that government ownership had a significantly and negatively influence on banks financial performance. Barth et al (2001) showed that government ownership of banks strongly correlates with banks inefficiency and lower productivity. Using CAMEL approach, Aswini et al. (2013) studied the soundness and efficiency of twelve public and private sector banks in India over the period 2000-2011. They found that private sector banks were at the top of the list, while public-sector banks were at the bottom of the list displaying low financial soundness in comparison. In terms of governments abusing their control on state-owned banks, Micco (2007) found that in developing countries government-owned banks are less profitable than their private counterparts and that the difference between the performance of public and private banks increases during elections years. Cornett et al (2010) looked at government ownership and government involvement in a country's banking system and their effect on banks financial performance during the period 1989 to 2004. They found that government-owned banks operated less profitably and had greater credit risk than privately-owned banks and the performance differences was more significant in those countries with greater government involvement and political corruption in the banking system.

On the other hand, Altunbas et al. (2001) studied bank ownership and efficiency in German banks and found little evidence to suggest that privately-owned banks are more efficient than their mutual and public-sector counterparts. AlAli and Al-Yatama (2019) examined the financial soundness of 9 banks listed at Kuwait stock exchange (KSE) over the period 2011-2016 using CAMELS model. Their results showed that Kuwait Finance House (KFH), which the government owns 48.05% of its shares, came at the 9th and last place in the list in terms of financial soundness. While Commercial bank of Kuwait, where the government does not own any shares in, came at the 8th place. Such result would imply that government ownership in banks does not really affects the financial soundness of the bank.

Unemployment have a severe effect on any economy. For that matter governments try their best to create jobs and government and mutually-owned banks are one of the channels governments use to employ more people even if that means higher overhead costs due to overstaffing and deteriorating financial performance of these banks. Creating and maintaining unneeded jobs in government-owned banks is based on political goals and not on economical or financials goals. La Porta et al. (2002) and Barth et al. (2004) believe that government-owned and to a certain extend mutual-owned banks do more harm than good to the economy because the hidden political agendas prevent them from fulfilling their expected role of economic prosperity. Clarke et al (2002) when examining the determinants of banks privatization in Argentina found that state-owned banks that are overstaffed had a poor financial performance and were the most difficult to privatize. They contributed the poor financial performance to the high staff expenses. They also looked at the political and social consequences of privatizing overstaffed bank since the new owners will layoff large number of the staff which in turn leads to higher unemployment which ultimately affects the government during election periods. Otchere (2005) found evidence that governments use banks to provide employment and subsidies to supporters in return for political contributions and votes. Using total assets-to-number of employees' ratio, as a proxy of overstaffing, the study found the ratio to be US$0.66 million in government owned banks compared to US$0.93 million in private banks. The study also showed that even in partially privatized bank, when the bank decides to make politically unpopular decisions regarding the staff reduction or closing unprofitable branches, these decisions are revoked by government assigned board members. Gupta (2005) also found that partial privatization did not change the objective of the Indian government in using these banks to absorb surplus labor, and as a result the research found that partially privatized banks are usually not as competitive and efficient as a fully privatized one.

Methodology

In order to determine which banks suffer from overstaffing, firstly we need to estimate the optimal number of staff a bank needs. In order to do so, panel OLS regression is conducted using formula 1, as follow;

$$\widehat{lnSt_t} = \alpha + \beta_1 ROA_t + \beta_2 lnTA_t + \beta_3 Lev_t + \beta_3 lnBr_t \quad (1)$$

Where $\widehat{lnSt_t}$ is the natural logarithm of the estimated number of staff required by the bank, ROA is the return on assets, TA is the total assets of the bank, Lev is the bank leverage, and Br is the number of branches the bank has. In order to examine if the bank is overstaffed or understaffed, the difference between the estimated numbers of staff is deducted from the actual number of staff as shown in equation 2;

$$\triangle St_t = St_t - \exp \widehat{lnSt_t} \quad (2)$$

For examining the effect of government ownership (Gov_t) on the financial performance of the bank, equation 3 is performed;

$$ROA_t = \alpha + \beta_1 Gov_t + \varepsilon \quad (3)$$

In determining the relation between government ownership and the staffing level difference in banks, equation 4 is performed;

$$\triangle St_t = \alpha + \beta_1 Gov_t + \varepsilon \quad (4)$$

Data and Empirical Results

This research is based on the financial data of 10 Kuwaiti banks that are listed at Kuwait stock exchange (KSE) over the period 2010-2018. The data for this research were downloaded from Kuwait Institute of Banking Studies (KIBS) website.

As seen from the descriptive analysis presented in table 1, the average number of staff employed per bank was 1144 employees. Bank had an average leverage ratio of 7.92 times with an average return on assets of 0.93%. By looking at skewness and kurtosis, it can be seen that they fall within the acceptable range of ± 1.96 and ± 10 respectively indicating normal distribution.

Table 1: Descriptive Analysis

	Staff	ROA	TA	Lev	Branches
Mean	1144.47	0.93	6564.47	7.92	39.20
Median	823.50	0.97	4137.60	7.84	37.00
Standard Deviation	684.75	0.51	6479.39	1.67	17.68
Kurtosis	-2.34	2.98	8.04	0.68	-1.07
Skewness	0.98	-0.72	1.68	-0.02	0.10
Count	88	88	88	88	88

Results of equation 1, is presented in table 2. Results show that the model can be labeled as a "good fit" since Sig F is less than 0.05. The model also has a good explanatory power with an adjusted R square of 0.890 indicating that the model was able to capture 89.0% 0f the variation in the number of staff.

Table 2: Panel OLS Regression Output

Adjusted R Square	0.890		Significance F	0.00
Standard Error	0.193			
Observations	88			
	Coefficients	Standard Error	t Stat	P-value
Intercept	2.620	0.205	12.781***	0.00
ROA	-0.126	0.050	-2.519**	0.0137
lnTA	0.277	0.042	6.581***	0.00
Lev	-0.0196	0.013	-1.480	0.143
lnBr	0.624	0.072	8.684***	0.00

*,**,*** indicate confidence level at 90%, 95%, and 99% respectively.

From the panel OLS regression results presented in table 2, the number of staff needed in the bank can be estimated as;

$$\widehat{lnSt}_t = 2.62 - 0.126\, ROA_t + 0.277\, lnTA_t - 0.0196\, Lev_t + 0.624\, lnBr_t \quad (5)$$

In plotting banks data into formula 5, it can be seen from table 3, that six bank suffer from overstaffing while the remaining four showed understaffing. Commercial bank was the most understaffed bank in Kuwait while Kuwait finance house was the most overstaffed bank. Kuwait finance house was overstaffed by 550 employees while Commercial bank was understaffed by 289 employees. National bank of Kuwait was the closest to their estimated staff needs with overstaffing of merely 4.41%. The table also shows that Kuwaiti government partially owns eight out of the ten banks, and only Commercial bank and Boubyan bank can be labeled as privately-owned banks. The Kuwaiti government has the highest ownership in Kuwait finance house, 48.05%, followed by Warba bank, 33.50%. It can also be observed from the table that the Kuwaiti government has the highest ownership in Kuwait finance house and that bank had the highest overstaffing, while Commercial bank was the most understaffed bank in Kuwait and the Kuwaiti government does not have shares in.

Table 3: Banks Under/Overstaffing

	Actual Staff	Estimated Staff	Under/Overstaff*	%	Government Ownership
AlAhli Bank	801	860	-59	-7.60%	10.13%
Burgan Bank	710	910	-200	-27.89%	8.43%
Commercial Bank	913	1202	-289	-31.98%	0.00%
Gulf Bank	1470	1366	104	6.79%	5.01%
National Bank of Kuwait	2207	2113	94	4.41%	5.60%
Ahli United Bank	753	852	-99	-12.82%	12.01%
Boubyan Bank	963	768	195	18.88%	0.00%
Kuwait Finance House	2496	1946	550	21.94%	48.05%
Kuwait International Bank	630	596	34	5.57%	8.04%
Warba Bank	319	300	19	6.71%	33.50%

*(-) indicate understaffing

Table 4 presents the relation between government ownership and both return on assets (ROA) and the divergence in staff number from the estimated staff required. In terms of the effect of government ownership on return on assets (ROA), it can be seen that there is a statistically significant inverse relation between the two variables. This might be caused by high employees' expenses due to overstaffing, forcing the bank into providing loans with low interest rates for political reasons, or keeping some unprofitable divisions or branches in the bank open for election purposes. By looking at the relation between government ownership and staffing levels, the results shows a statistically significant direct relation between them implying that the Kuwaiti government uses these banks as hiring channels, resulting in overstaffing. To force the banks that the government have a small or no ownership in them into hiring more local workers, the council of ministers issued a law in early 2019 which increases the minimum percentage of Kuwaiti workers in the banking sector from 64% to 70% which is roughly around 676 new jobs for Kuwaiti workers. Finally when examining the relation between overstaffing and the financial performance of the banks, results shows no relation between these two variables meaning that over or understaffing does not affect the financial performance of Kuwaiti banks to a certain extend. This can be caused by the support the government provides to the banks in terms of very low interest rate deposits which in turn increases the interest rate margin the bank makes on loans they provide to their customers. These deposits are used as compensation for high staffing expenses due to overstaffing.

Table 4: Panel OLS Regression Output

Dependent	ROA			$\triangle St_t$			ROA		
Independent	Gov_t			Gov_t			$\triangle St_t$		
R Squared	0.0638			0.1587			0.0002		
Standard Error	0.4980			0.1786			0.5147		
Sig F	0.0176**			0.0001***			0.8932		
	Coefficient	t-Stat	P-Value	Coefficient	t-Stat	P-Value	Coefficient	t-Stat	P-Value
Intercept	1.046	14.92***	0.00	-0.084	-3.34***	0.0012	0.936	16.980***	0.00
independent Variable	-0.883	-2.42**	0.0175	0.527	4.027***	0.0001	0.038	0.1345	0.893

*,**,*** indicate confidence level at 90%, 95%, and 99% respectively.

Conclusion

The purpose of this research was to examine the effect of government ownership on both the staffing level and the financial performance of Kuwaiti banks. Using the data of 10 banks listed at Kuwait Stock Exchange (KSE) over the period 2010-2018, results showed that there was a significant direct relation between government ownership and the level of staffing in these banks which indicates that the Kuwaiti government uses its ownership power to force banks into hiring more staff for political reasons. The results also showed significant inverse relation between government ownership and the financial performance of the banks which overstaffing is one of the reasons for it.

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