

CORPORATE REPORTING, SECURITY REGULATION AND TRADING ON THE KUWAITI STOCK EXCHANGE (KSE) – INSTITUTIONAL IMPLICATIONS FOR RESEARCH

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Abstract

The regulation of equities trading in Kuwait over the period from 1983 to 2011 is documented in this paper. An eclectic approach has resulted in overlapping responsibilities for the three main regulatory and supervisory bodies. Regulation appears to be responsive to market crises. As a result, regulations have tended to change with market conditions. Kuwaiti accounting and auditing requirements are also reviewed. The institutional setting in Kuwait has a number of implications for capital market based research. Informational inefficiency precludes research that relies on the assumption that security price reflects firm value. Other features (including the profit requirement, lock up restrictions and the two auditor rule) provide opportunities for capital market research in Kuwait.

Key-words: Corporate Reporting, Security Regulation, Trading, Kuwaiti Stock Exchange

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1 Introduction

The focus of this paper is the regulation of equities trading in Kuwait. Equities are currently traded on the official market – the Kuwait Stock Exchange (KSE) or on the ‘parallel market’ which facilitates the trading of companies that cannot meet the listing requirements of the main board of the KSE. Increasingly, capital markets researchers are finding that institutional features of markets impact on the applicability of theories developed in different markets provide both challenges and opportunities for research. Therefore, this paper contributes to the developing literature based in Kuwaiti financial markets by documenting changing regulations relevant to equities trading over the last three decades.

The history of regulation of equities trading in Kuwait is largely characterised as ‘regulation in response to crises’. Therefore, the first section of this paper outlines significant economic events to contextualise the discussion of regulation in section 4. A brief overview of the types of equities that trade on the KSE is presented in section 3. Institutional arrangements for the accounting and auditing profession are discussed in section 5. The paper concludes with some implications of Kuwaiti institutional for accounting and finance research.

2 Kuwait Stock Exchange and Major Events

The Kuwait Stock Exchange (KSE) ranks first in the Arab world based on turnover ratio, second in stock-value traded, and third in market capitalization (Aldaihani and Aldeehani, 2008). The public corporation has a relatively short history in Kuwait compared with western economies. Al-Yaqout (2006) identifies the discovery of oil, the subsequent influx of revenue and the Kuwaiti government’s recognition of the benefits of corporate structures developing the economy as the critical factors in the emergence of the corporation in Kuwait. The National Bank of Kuwait, established in 1952, became the country’s first public company (Al-Sultan, 1989, Bley and Chen, 2006). The major events relevant to regulatory changes discussed are the 1976-1977 crisis, the Al-Manakh crisis, the Gulf War, the boom of 2003-2005 and the global financial crisis.

2.1 The inception of corporate regulation and the 1976-77 crisis

The Commercial Companies Law (No.15), the first legislation to organise and regulate companies in Kuwait, was promulgated in 1960. However, the first significant step toward regulating domestic securities trading did not occur until the introduction of Law No.32 in 1970 (Al-Yaqout, 2006; Alanezi, 2006). Law No.32 created a consultation committee to supervise trading, designed the stock market

framework, attempted to protect the economy from stock price volatility, and provided for the assessment of foreign companies seeking to register their shares in the market. Stock trading on the exchange commenced in 1977 (Gomers *et al.*, 2008; Masih *et al.*, 2010).

The Kuwaiti stock market was characterized by a rise in speculative activities in the 1970s (Hassan *et al.*, 2003) as large numbers of inexperienced investors enthusiastically entered the market (Al-Yaqout, 2006; Alanezi, 2006). This rise in speculative trading was fuelled by the “forward method”, which allowed traders to use post-dated cheques to settle payments (Al-Qenae, 2000; Al-Yaqout, 2006; Alanezi, 2006). Effectively, shares were purchased at multiples of the current price with deferred settlement (Al-Sultan, 1989) and lack of funds to invest was no impediment to trading. Combined with a lack of sufficient regulation, these features provided scope for key investors to manipulate the market for short-term gains during this period (Al-Qenae, 2000).

By late 1976, the rapid rise in trading activity and huge inflation of share prices contributed to a calamitous market collapse. Demand from investors fell as stock prices rose and the widespread use of the “forward method” of settlement created significant levels of debt for investors (Al-Yaqout, 2006), the clearing system was inadequate and the organization of the stock market remained poor (Al-Qenae, 2000; Al-Yaqout, 2006; Alanezi, 2006). By the end of 1977, stocks prices had fallen sharply and trading volume dropped 66% compared with the previous year (Al-Sultan, 1989; Al-Yaqout, 2006). In response to the collapse, the government placed a moratorium on the establishment of any new local shareholding companies or new equity raisings by existing companies from 1977 to 1979 (Al-Sultan, 1989).

2.2 The Al-Manakh crisis, 1982

As the investment opportunity set for Kuwaiti investors was constrained by the ban on new shareholding companies and new equity issues by existing companies, ‘Gulf shareholding companies’ provided popular investment vehicles. These Gulf companies were effectively owned by Kuwaiti investors but were incorporated in the Gulf Emirates (Al-Sultan, 1989) and, as such, were prohibited from trading on the official Kuwaiti market (Al-Qenae, 2000). The Kuwaiti over-the-counter (OTC) or ‘Al-Manakh Stock Market’ developed to trade Gulf companies (Elshamy and Al-Qenae, 2005) and unlisted Kuwaiti Closed Shareholding Companies (Al-Sultan, 1989). This unregulated market was popular with investors, generating four times the trading volume of the official market and double the equity base of the official market (Al-Sultan, 1989). After a meteoric rise, the OTC index fell by 45% in the six months to August 1982 (Al-Sultan 1989).

Investors once again failed to cover their post-dated cheques and the OTC market collapsed (Oxford Business Group, 2006b).

Analysts agree that the failure of the OTC market, known as the ‘Al-Manakh crisis’ was caused by inadequate government regulation, insufficient financial disclosure, frivolous speculation, the use of post-dated cheques, and lack of government control over Gulf shareholding companies (Al-Mutairi, 2004). The crisis precipitated the Ameri Decree which reorganised the Kuwaiti stock market as an independent financial institution guided by an executive administration and a Market Committee to protect investors, issuers, and brokers (Oxford Business Group, 2006a). The KSE was then established and trading commenced in 1984 (KSE, 2010a). Regulators tightened market controls by stiffening listing requirements (Alsaman, 2002). As a result, the numbers of new listings, shares issued, and stockbrokers were limited. Numerous regulations were also promulgated to bolster investors’ confidence in the market (Al-Qenae, 2000) and the government spent many years trying to control debt and scheduling settlements for outstanding post-dated cheques after the Al-Manakh crisis.

2.3 The Gulf War, 1990-1991

The invasion of Kuwait was a major shock to the nation and to its economic system. The massive destruction that followed changed the development path of the Kuwaiti economy (International Monetary Fund, 2005). An unfortunate implication for research is that much historical data were lost, constraining the sampling timeframe for Kuwaiti market research.

The post-war period in Kuwait was a challenging one. Economic performance suffered greatly in the 1990s, and the KSE was closed from August 1990 to September 1992 (Annual Economic Report of the KSE, 1990/1991). After reopening, the KSE struggled to rebuild investor confidence and stock market activity remained sluggish. The Kuwait Automated Trading System (KATS), designed to improve market competition, liquidity, and transparency, was introduced in 1996 (Annual Economic Report of the KSE, 1996). The KATS facilitates faster transactions than were possible under the previous manual system, allowing traders to register their bids and offers which are then matched according to the priority of prices (Al-Hashel, 2003). With the introduction of the automated trading system, investor trust was gradually regained and the KSE again became active (Annual Economic Report of the KSE, 1995; International Monetary Fund, 2004).

2.4 The boom, 2003-2005

The elimination of Saddam Hussein’s regime in April 2003 coupled with higher international prices for

crude oil contributed to an economic boom in Kuwait during the 2003-2005 period (International Monetary Fund, 2004; Oxford Business Group, 2006b). Greater economic and political security prompted increased investment on the exchange and in new business initiations. The resultant increase in liquidity and financial growth in Kuwait contributed to the KSE ranking among the best-performing stock markets worldwide in 2003 (Oxford Business Group, 2006b). A sharp rise in market capitalization, new corporate listings (specifically IPOs), and market index values was experienced in 2004 and 2005 (Annual Economic Report of the KSE, 2004; 2005). Further, many Kuwaiti firms benefited from profitable reconstruction projects in Iraq.

2.5 The global financial crisis, 2008

The financial crisis that began in the United States in 2008 quickly spread to countries around the world, leaving collapsed financial markets, economic recession, rising unemployment, and personal and business bankruptcies in its wake. Various factors created the crisis, but a chief cause was the poor quality of subprime mortgages in the United States (Shiller, 2008). Kuwait faced a difficult financial situation, as did many countries around the world (Al-Mutawaa, 2009). The KSE index experienced large losses relative to some of the leading stock markets¹. That the crisis affected Kuwait, a small country with no outstanding debt, to the same extent as many larger countries with more debt, surprised many (Al-Mutawaa, 2009). This disproportionately large response in the Kuwaiti economy can be attributed to four main factors: strong negative investor sentiment on the KSE; a rapid decrease in the value of listed investments; lower oil prices and the large exposures of some Kuwaiti financial institutions to poorly performing foreign investments (Al-Mutawaa, 2009). Moosa (2010) is less surprised by the impact of the crisis on the KSE. He shows that the level of integration of the KSE with US markets is not high and argues that Gulf Co-operative Council (GCC) stock markets (including Kuwaiti) were subject to domestic factors that were major contributors to the severity of the stock market response.

In response, Kuwaiti government regulators and financial institutions joined forces to take actions to support the economy. The Central Bank of Kuwait (CBK), for example, lowered interest rates on loans and directed banks to increase their capital to enhance the stability of the banking sector (Al-Mutawaa, 2009). KSE investors, however, were not sufficiently impressed by such efforts and a lawsuit

¹ The percentage change in the KSE index from closing prices for 2007 to those of 2008 was -43.12%. In comparison, the change in the FTSE 100 index (London Stock Exchange) for the same period was -31.33%, the NYSE Composite index (New York Stock Exchange) was -40.89% while the NIKKEI 225 (Tokyo Stock Exchange) lost 42.12% over the same period (Al-Mutawaa, 2009).

against the KSE was filed by one group attempting to recoup their losses (Al-Atrabi and Al-Sayed, 2008). As a result, on November 13, 2008, the Administrative Court in Kuwait suspended all trading on the KSE for two working days (Al-Shal Report, 2008). This action set a striking precedent for the KSE. Trading had not been suspended even during the worst days of Al-Manakh crisis. Many financial analysts considered that the decision to suspend trading was ill conceived and revealed the Kuwaiti regulators' inability to cope with the crisis. They argued that market forces should be allowed to prevail even when resultant clearing prices are extreme and that the losses the Kuwaiti market incurred were no different than those sustained by other markets around the world (Al-Shal Report, 2008). They further contended that a decision to suspend market transactions should be treated as a matter of national security, not jurisprudence (Al-Shal Report, 2008).

Kuwait was the last of the GCC countries to establish a Capital Market Authority (CMA) when the Kuwaiti Parliament enacted the Capital Market Law in February 2010 (Eiman 2010). The law was gazetted on March 13, 2011 and its objective is to create the CMA as a single, independent, accountable authority, managed by a Board of Commissioners with the power to develop and regulate the capital market in Kuwait. This step is anticipated to enhance transparency, trust and confidence in the Kuwaiti financial system and represents the most recent regulatory change at the time of writing. The next section provides a brief overview of the types of companies that list on the KSE.

3 Equities Trading On the Kse

Shares of companies listed on the KSE are classified into eight sectors: banking, investment, insurance, real estate, industrial, services, food, and non-Kuwaiti companies (KSE, 2010b). Consistent with most investors internationally, shareholders have limited liability and are not responsible for the company's obligations except to the extent of the face value of the shares subscribed (Law No.15, 1960). Article No. 10 of the Ameri Decree (1983, p. 13) specifies the following entities as members of the KSE:²

- Kuwaiti Public Shareholding Companies (KSCs)
- Kuwaiti Closed Shareholding Companies (KSCCs)³
- Middlemen of the Stock Exchange (stockbrokers)

² Stock exchange members must pay registration fees and an annual subscription fee.

³ KSCCs may be either listed or unlisted. KSCCs are incorporated by an official document issued by the promoters, of whom there must be at least five. Shares of KSCCs are freely transferable, subject to the requirement of Kuwaiti ownership of at least 51% (Law No.15 1960). Both KCSs (or IPOs) and KSCCs are defined as listing companies.

Commercial Companies Law No.15 (1960) identifies KSCs as public offerings securities companies. The procedure for listing KSCs is consistent with the initial public offering (IPO) process documented for most developed markets where the company invites a public subscription prior to listing. In contrast to many other markets, a decree must be issued and published in the official gazette, announcing the incorporation of the KSC before the company can apply to list. Further, the KSC must have been established for at least one year prior to seeking listing (Law No.15, 1960).

The vast majority of companies listing on the KSE are KSCCs. In the period from 1997 to 2007, for example, only seven from a total of 92 listing firms in the non-financial sectors were KSCs (or IPOs). In contrast to the KSCs that list to raise capital, KSCCs do not normally offer shares for public subscription immediately prior to listing (National Bank of Kuwait, 2007; Oxford Business Group, 2006c)⁴. The objective of listing a KSCC is to switch from private to public ownership via the sale of vendor shares to the public. The original shareholders decide the selling price of the shares and proceeds go directly to the vendors (IPO Monitor, 2010).

The Commercial Companies Law does not require the issue of a decree for the incorporation of closed companies. Listing KSCCs must, however, meet a specific set of requirements issued by the Market Committee and issue a prospectus⁵ that should be available on the first day of trade. The prospectus should include full sets of audited financial statements and the auditor's reports for the three years prior to listing (KSE, 2010c). The KSCC usually appoints a listing consultant when applying to have shares traded on the KSE. The consultant is responsible for filing the company's legal documents and assists with the preparation of the prospectus. The consultant also reviews the financial status of the company, including the company's compliance with accounting regulations (Listing Consultants, Personal Communication, May 27, 2009).

A distinction claimed by no other stock exchange is the KSE trading hall for ladies. The Ladies Trading Hall opened in January 2003 with the objective of creating an adequate environment for business women and granting women equal rights to men in terms of managing their investments (Annual Economic Report of the KSE, 2003). It contains the facilities needed for women to closely follow market activity.

⁴ KSCCs have been required by the Market Committee to offer shares for private subscription if the spread of shareholders is insufficient since 2007.

⁵ The prospectus must also include general information about the company, the history of the company and its affiliates for the last five years, descriptions of company property, the legal status of any cases filed by or against the company and information on the company's shares and shareholders. (KSE, 2010c).

4 Regulation And Supervision

The capital market in Kuwait is regulated and supervised by three enforcement bodies: the Ministry of Commerce and Industry (MoCI), the KSE Market Committee and the Central Bank of Kuwait (CBK). The role of each of these institutions, with respect to equities, is discussed in this section.

The MoCI is responsible for the licensing of market intermediaries and for the regulation and supervision of the primary market. More specifically, the ministry oversees Market Committee decisions, such as listing new companies, listing terms and conditions, and company mergers (Al-Jarrah, 2008; Oxford Business Group, 2006b).

The Market Committee supervises the management of KSE and is responsible for setting the general rules and policies for the exchange. Article No.5 (1983) stipulates that the Market Committee must be organized under the chairmanship of the MoCI. Internal rules and regulations on matters including the structure of the stock exchange, financial regulations, registrations, and KSE membership are the domain of the Market Committee. It is also responsible for issues relating to KSE dealings, securities, registration of stockbrokers and applications for listing including the inspection of applicant company financial statements. Since its inception, the Committee has actively issued resolutions regulating the market.

Based on the requirements of the Ameri Decree of 1986, the Market Committee created the Kuwait Clearing Company (KCC) in Resolution No.13 (1987) (Al-Qenae *et al.*, 2002; Annual Economic Report of the KSE, 1987). All investors and traders must hold an account with the KCC to trade on the KSE. The KCC clears transactions, registers shares, resolves obligations and rights arising from market transactions, and specifies the parties and their respective rights for each transaction. The KCC also provides a central depository service for listed and non-listed companies' securities and for domestic and foreign investors. In addition, the KCC provides a range of other services including the distribution of profits and the administration of some IPO subscriptions (Al Mohasiboon Magazine, 2009b).

The CBK was established in 1969 to set the rules of the Kuwaiti financial system (Islam, 2003). It controls currency management and the organization of the banking sector (Law No.32, 1968). The CBK supervises listed banks, investment companies, and exchange houses (Law No.32, 1968). Mutual funds, however, have been supervised by the KSE Market Committee since July 2005 (Ameri Decree No.158, 2005). The CBK has the power to inspect institutions under its supervision at any time for compliance with its provisions, laws, resolutions, and regulations (Central Bank of Kuwait, 2009). It plays a substantial role in the supervision of KSE listed companies as

around thirty percent of these are banks or investment companies⁶.

Prior to 2011, the KSE was the only market in the Gulf region without an independent regulatory body to manage its capital market (Al Mohasiboon Magazine, 2006). The primary market for equities is supervised by the MoCI while the secondary market is supervised by the Market Committee and the CBK supervises financial institutions. The absence of one cohesive regulatory body for the KSE has resulted in conflict between the regulators and there are many historical examples of the regulators being unable to fulfil their duties. Both domestic and international observers agree that the KSE suffers from a weak governing structure and that its management and regulatory framework contains significant flaws as a result of diverse laws and regulating agencies (Aldahani and Aldeehani, 2008; Bouresli, 2009; International Monetary Fund, 2004). The KSE enforcement agencies issue numerous interrelated regulations that are practically impossible to track and thus undermine consistent enforcement (International Monetary Fund, 2004; Oxford Business Group, 2006b).

The practical functioning of the Market Committee and the KSE illustrates the confusion among KSE regulatory agencies. The Market Committee, charged with managing the detailed affairs of the KSE, is presumed to oversee the KSE. In practice, however, the Market Committee and the KSE are effectively a single entity with dual functions and responsibilities (Bouresli, 2009; International Monetary Fund 2004; Kuwait Chamber of Commerce and Industry, 2006). While the KSE and the Market Committee share the same management body, it will remain difficult for the Market Committee to uncover and address violations and shortcomings of the KSE (Al-Jarrah, 2008). The current practice results in a clear conflict of interest and in a division of power that precipitates weak surveillance, inconsistent enforcement, and contradictory regulations (International Monetary Fund, 2004). The second Kuwait Conference on Transparency in 2008 concluded that the Market Committee had not been granted the requisite power and responsibility to act as an independent regulatory agency and to oversee the development of a securities market that is efficient, fair, and transparent. It was, therefore, recommended that the Market Committee should be separated from the KSE and operate with its own resources, staff, and authority (Oxford Business Group, 2006b).

Conflict among agencies regulating the KSE is institutionalised by Article No.5 of the Ameri Decree (1983). This article declares that “the Stock Exchange shall be managed by a committee, to be constituted under the Chairmanship of the Minister of Commerce and Industry.” While this legislation was

proposed to better organize the KSE it effectively weakened oversight and illustrates the divergence between the technical and the political functions of the Minister of the MoCI (Al-Jarrah, 2008). Further conflict is found in the Market Committee’s responsibility to regulate and supervise brokerage firms at the KSE while the MoCI is responsible for licensing the brokers (International Monetary Fund, 2004; Oxford Business Group, 2006b).

As the chief clearing and settlement institution, the KCC works under the umbrella of the KSE. Meanwhile, the KCC also operates as the securities depository and registry. These two functions should be separated (International Monetary Fund, 2004). In most other exchanges, securities must be deposited with the clearing and settlement institution, while the cash transfer must be made directly through financial institutions (Kuwait Transparency Association Report, 2006). Therefore, it is inappropriate for the KCC to act as an investment custodian for stock while holding the settlement cash. Moreover, the KSE owns 27.5% of the KCC (Kuwait Transparency Association Report, 2006). This level of ownership has the capacity to bias KCC decisions and demonstrates that the KCC does not have the requisite independence to duly fulfil its tasks (Kuwait Transparency Association Report, 2006).

In brief, Kuwait’s system is unique and eccentric compared to other regulatory systems for stock markets (Kuwait Transparency Association Report, 2006). Most other stock markets have a Capital Market Authority, which has the executive ability to meet its responsibilities and the full powers to develop and regulate the market. The establishment of the CMA may achieve strengthening of the securities regulatory framework for the KSE to international standards. The next section documents the historical development of the listing requirements of the KSE and their evolution.

4.1 Evolution of the listing requirements

This section presents an overview of the legislation and regulations specifically relevant to the official and parallel markets over the period from 1983 to 2010. This period captures two critical developments – the Ameri Decree in 1983 which reorganised the KSE following the Al-Manakh crisis and the legislation that enables the establishment of the Capital Market Authority in 2011.

Article No.6, item No.3, of the Ameri Decree (1983) stipulates that the “Market Committee is responsible for setting the general rules and policies for the KSE; in particular it shall set the rules and procedures for enrolling brokers and listing shares of Joint stock companies and any other securities in the market.” Market entrance guidelines for both the official and parallel markets are set by the Market Committee. Activity on the parallel market has decreased substantially since the Al-Manakh crisis

⁶ Of the 185 KSE listed companies as at March 2010, 9 were banks and 49 were investment companies.

discussed earlier. In December 2011, only 14 companies are listed on the parallel market compared with 216 on the official market. Listing regulations for the official market are discussed in section 4.1.1 and those for the parallel market follow in 4.1.2.

4.1.1 Listing Requirements for the Official Market

Resolution No.1 (1984) was the first following the reorganization of the KSE in 1983. It instituted the listing requirements and it provided for their enforcement in the Official Market. Consisting of only four articles, it required that a company seeking listing on the KSE have a minimum paid-in capital of KD 5 million, have been established for at least three years prior to listing and have obtained a profit of at least 5%⁷ over these three years. In addition, it empowered the Market Committee to exempt some companies from the listing requirements based on the nature of their activities and purposes. This legislation instituted paid-in capital, minimum firm age and a profit requirement as the foundations for KSE listing requirements.

The provision of a prospectus (including the company's history and financial status duly authorized by the company's management and external auditor) to the Market.

Committee was first required by Resolution No.4 (1988). Interestingly, Resolution No.4 (1988) specifies that trading in the company's shares commence at book value. The first trading price can be different to book value if approval is provided by the Market Committee.

The discussion in the remainder of this section relates to Table 1 which provides a summary of the listing requirements from 1984 to 2011. Released during Kuwait's rehabilitation and reconstruction period following the Gulf War, Resolution No.1 (1993) revoked Resolution No.1 (1984). The main effect of this new legislation was to reduce the barriers to listing. Resolution No.1 (1993) integrated the parallel and official markets and reduced the required level of paid-in-capital to KD 1 million. The pre-listing profit requirement was softened to the constraint that companies seeking listing not have losses in the previous year's financial statements.

Following post-war reconstruction and partial economic recovery, Resolution No.1 (1997) again tightened the KSE listing requirements. One of the most important changes was the requirement for at least KD 2 million share capital and at least KD 3 million shareholders' equity. Resolution No.1 (1997) does not elaborate on the difference between 'capital' and 'shareholders' equity' so this presumably relates to an implicit requirement that listing companies have retained earnings on the balance sheet. The pre-listing profit requirement was reintroduced and specified as net profit from the company's main

activity of at least 5% of its paid-in capital for each of the two years prior to listing.

Resolution No.1 (1997) gave the Market Committee the right to exempt or reject any company from listing without justification. The Market Committee strengthened the listing requirements once again by replacing Resolution No.1 (1997) with Resolution No.3 in 2004 and Resolution No.7 in 2005, respectively. While Resolution No.3 (1998) identified that 'a sufficient' number of shareholders was required for listing, Resolution No.3 (2004) quantified the minimum number of shareholders required to list a company for the first time.

The introduction of the 'strategic' shareholder and 'lock-up' requirements (Resolution No.7, 2005) followed a period of rapid growth in the number of companies listed on the KSE.⁸ A *strategic shareholder* was defined as "the one who owns, directly or indirectly, 5% or more of a company's capital" (Resolution No.7, 2005). The total proportion of shares held by strategic shareholders in a company seeking listing could be no less than 25% of the company's capital, whether owned by one or more strategic shareholders. Further, to protect new investors by guaranteeing the continuing participation of firm insiders (or share vendors) after going public, restrictions on shares were imposed.

Lock-ups are normally defined as agreements made by insiders of stock-issuing firms to abstain from selling shares for a specified period of time after the issue (Brau *et al.*, 2005). However, lock-ups in Kuwait are mandated by law, so the term 'lock-up restriction' is used here to differentiate these from the voluntary lock-up agreements prevalent in other markets. Resolution No.7 (2005) required that all listing KSCCs retain 25% of the company's capital, specifically the strategic shareholders' shares, at the clearinghouse. Figure 1 shows the lock-up restriction periods and the proportion of strategic shareholder shares that can be offered to the market at the expiration of each.

In addition to being a listing requirement, the lock-up restriction in the Kuwaiti setting is unique in two further ways. Firstly, there are three fixed expiration periods, after which strategic shareholders are allowed to dispose of their shares. The first expiration period is after the first listed year, the second is after the second listed year and the final expiration period is after the third listed year. Secondly, a specific maximum percentage of shares can be disposed of in each period. Fifty-percent of the total restricted shares can be disposed of at the first expiration period, twenty-five percent at the second expiration period while the remaining 25 percent cannot be sold until the third expiration period.

⁷ Resolution No.1 (1984) did not define 5% profitability.

⁸ There were thirteen new listings on the KSE in 2003, nineteen in 2004, thirty-three in 2005, and twenty-one in 2006.

Table 1. Evolution of the Official Market listing requirements for KSCCs – 1984 to 2010

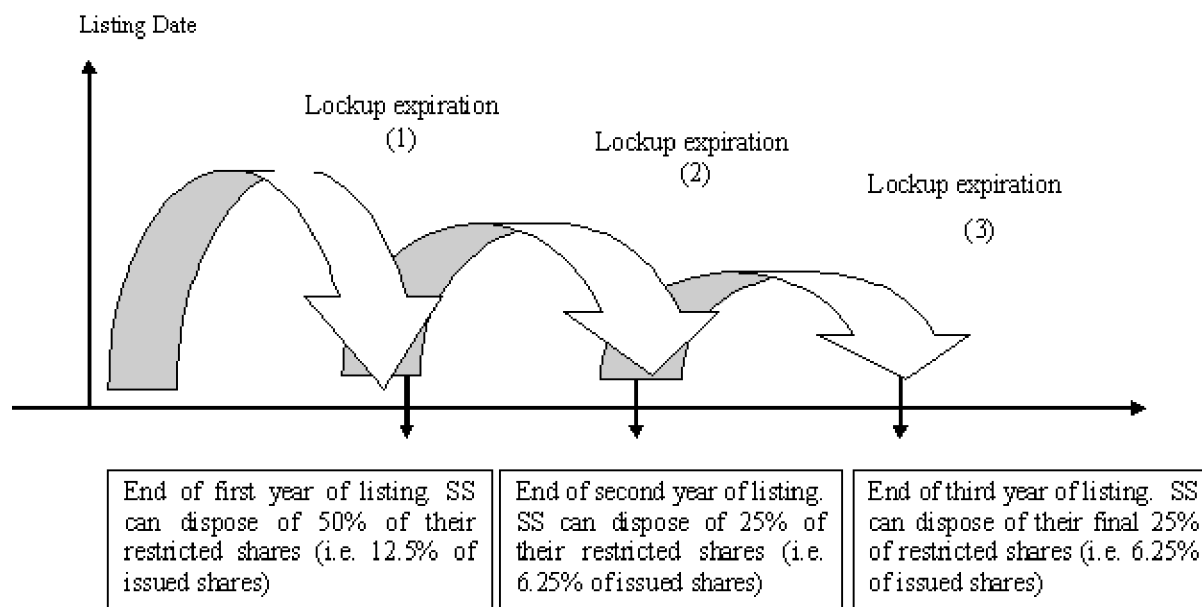
<i>Legislation</i>	<i>Capital requirement</i>	<i>Profit requirement</i>	<i>Additional requirements</i>
Resolution No. 1 (1984)	4 million KD	No less than 5% profit for three years prior to listing	- Companies applying for listing must be established for three years prior to the application
Resolution No. 4 (1988)	5 million KD	Not less than 6% of operational profit for three years prior to listing	- Distributed cash dividend of at least 5% during the year prior to listing - At least three audited annual financial statements issued prior to listing - Prospectus prepared for approval by company management and external auditor - Shares traded based on book value or other value approved by the Market Committee
Resolution No. 1 (1993)	1 million KD	No reported losses during the financial year prior to listing	- Prospectus prepared for approval by company management and external auditor - Shares traded based on book value or other value decided by the Market Committee
Resolution No. 1 (1997)	2 million KD	Net operational profit not less than 5% of its paid-in-capital for two years prior to listing	- If company has effectively increased its capital, one year must elapse prior to listing - Capital must be distributed among a sufficient number of shareholders; if not, the Market Committee may require the company to offer 25% of its capital for private subscription - Prospectus prepared for approval by company management and external auditor
Resolution No. 3 (1998) Amendment to Resolution No. 1 (1997)	2 million KD	Average operational profit not less than 5% of paid-in-capital for two years prior to listing Company must have reported operational profit for the financial year prior to listing	- Shareholders' names and ownership percentages to be submitted immediately after Market Committee listing approval - Complete listing procedures within 45 days of listing approval
Resolution No. 3 (2004)	3 million KD	Average operational profit not less than 7.5% of paid-in-capital for two of the three years prior to listing	- If company has effectively increased its capital, one year must elapse prior to listing - If capital is 3 million KD, there must be at least 150 shareholders, each with 20,000 shares representing in total at least 20% of the paid-in-capital

<i>Legislation</i>	<i>Capital requirement</i>	<i>Profit requirement</i>	<i>Additional requirements</i>
Resolution No. 7 (2005) Amendment to Resolution No. 3 (2004)	3 million KD		<ul style="list-style-type: none"> - A strategic shareholder is one who owns, directly or indirectly, 5% or more of a company's capital shares - A strategic shareholder in a company seeking listing must hold at least 25% of the company's capital, whether owned by one or a group of strategic shareholders - Lock-up restrictions are imposed. 50% of the strategic shareholder's shares must not be sold during the first year of listing, 25% during the second year of listing
Resolution No. 1 (2007)	10 million KD	Not less than 7.5% of paid-in-capital for each of the two years prior to listing	<ul style="list-style-type: none"> - If a closed company has increased its capital by more than 50%, one year must elapse from the date of notice in the commercial registry to listing - Companies must offer 30% of their capital for private subscription and the offer is to be managed by a specialized company that must be independent from the company seeking listing - Shareholders' equity to be not less than 115% of paid-in capital for each of the last 3 years - Strategic shareholders must hold at least 25% of the company's capital, whether owned by one or more strategic shareholders - 50% of the strategic shareholder's shares must be retained for the first year after listing, 25% for the second year after listing
Resolution No. 2 (2008)	10 million KD	Not less than 7.5% of the weighted average of the paid-in-capital for each of the last two years	<ul style="list-style-type: none"> - If a closed company has increased its capital by more than 50%, one year must elapse from the date of notice in the commercial registry to listing - 30% of a company's capital must be distributed among a sufficient number of shareholders which is specified by the Market Committee. If the percentage is not achieved, the company must offer 30% of its capital for private subscription with the offer managed by a specialized company - ratio of paid-in capital to shareholders' equity to be not less than 115% of weighted average paid-in capital for the last 2 years - 25% of the company's capital must be retained at the Kuwait clearing company for two years after the day of listing

The concept of strategic shareholders continues for companies trading in the parallel market (Resolution No.2, 2007). It was, however, abandoned for the official market by Resolution No.2 (2008) and replaced by the requirement that 25% of the paid-in

capital of the listing company be retained at the clearinghouse for two years from the date of listing. Thus, the contribution of shares required for the restriction can now be met with smaller parcels of shares.

Figure 1. Lock-up expiration periods at the KSE – November 27, 2005 to November 6, 2008



From 2007 onward, companies seeking listing must offer 30% of their capital to the market (Resolution No.1, 2007). These offers are managed by specialized companies that must be independent of the listing company. In addition, shareholders' equity must be no less than 115% of the paid-in capital in each of the last three years. The most recent alteration to listing requirements occurred in 2008 with Resolution No. 2. This resolution altered the calculation of the base percentage of the total shareholders' equity and pre-listing profit from paid-in capital to weighted average paid-in capital. The ratio of paid-in capital to total shareholders' equity was also adjusted to 115% of the weighted average of the paid-in capital in the past two years.

In contrast to Resolution No.1 (2007), which obligates companies seeking listing to offer 30% of their capital for private subscription, Resolution No.2 (2008) requires that 30% of the company's capital be distributed among a number of shareholders specified by the Market Committee. If this percentage is not available, the company must offer 30% of its capital for private subscription through a specialized company independent from the company seeking listing.

In summary, the listing requirements of the Official Market have been introduced, removed or modified frequently over relatively few years. During the period from 1984 to 2011, the capital requirement was increased, reduced and then increased again.

Lock-up restrictions were imposed then altered while the concept of strategic shareholdings was introduced then removed. The most volatile listing requirement for the KSE is for pre-listing profits. The pre-listing profit requirement started at 5% in Resolution No.1 (1984), increased to 6% in Resolution No. 4 (1988), changed to zero in Resolution No.1 (1993), and was reintroduced at 5% in Resolution No.1 (1997). From 2004 until 2011, the pre-listing profit requirement remained stable at 7.5%, with the only change being to the base used for calculating the required profit percentage.

It has been argued that the organization and supervision of the KSE has been largely neglected by the relevant authorities (International Monetary Fund, 2004). Few countries in the world lack comprehensive legislation to organise their stock markets but Kuwait's law facilitating the establishment of the CMA is very recent. The regulatory climate and framework for the KSE is generally inconsistent with the conditions needed to achieve the objectives and principles advocated by the International Organization of Securities Commission (International Monetary Fund, 2004).

Since its inception, the KSE can only be described as unstable (Aldaihani and Aldeehani, 2008). This instability can be attributed, in part, to the process of issuing regulations in response to the political and market crises outlined in section 2 rather than the early adoption of a coherent regulatory

framework for the KSE. Al-Nefeesi (2008) argues that the KSE has more gaps and deficiencies than do other emerging markets and that the KSE's development has been hampered by the lack of an appropriate legal and institutional framework. The next section will discuss and review the listing requirement of the parallel market.

4.1.2 Listing requirements for the parallel market

As discussed in section 2.2, the Al-Manakh market facilitated trading of GCC companies and KSCCs that did not meet the listing requirements of the official market. Following the reorganization of the KSE in 1983, the Parallel Market was established to replace the Al-Manakh market (Annual Economic Report of the KSE, 1988). GCC companies were admitted to the official market in May 1989 when it was opened to investors who were citizens of the GCC. Cross-listing of GCC companies was also permitted from this time (Annual Economic Report of the KSE, 1988). Following a brief closure, the market was reopened in 1989 with a new set of listing requirements that permitted GCC and Kuwaiti companies that did not meet the requirements of the official market to trade (Annual Economic Report of the KSE, 1989).

Resolution No.6 (1989) included the requirement for a minimum paid-in-capital of KD 1 million to trade on the parallel market compared to KD 5 million on the official market. The amount of historical financial information was also lower with two audited annual financial reports required prior to listing whereas three were required for the official market. While there was a 6% pre-listing profit requirement for listing on the official market, there was no profitability requirement for the parallel market.

In 1993, the Market Committee again combined the parallel and official markets with a single set of listing requirements (Resolution No.1, 1993). Kuwait continued with one market for seven years until Resolution No.4 (2000) re-established the parallel market (Annual Economic Report of the KSE, 2000). The listing requirements for the Parallel Market are summarised in Table 2.

Resolution No.1 (2003) allowed parallel market companies to transfer to the official market once they had been listed for one year on the parallel market and met the official market listing requirements. Resolution No.2 (2007) introduced a profit requirement for parallel market companies, increased the required level of capital and mandated that 25% of the company's capital, specifically the strategic shareholders shares, be retained at the clearinghouse. Two fixed expiration periods were introduced in Resolution No.2 (2007). Strategic shareholders are permitted to dispose of 25% of total restricted shares during the second year of listing while the remainder can be sold during the third year of listing.

Regulations for the parallel market have undergone numerous reforms. During the past three decades, this market has been thrice activated, once suspended, and once merged with the Official Market. Listing requirements have been less onerous than those of the official market, especially with respect to the pre-listing profit and capital requirements (Resolution No.1, 1997; Resolution No.2, 2007; Resolution No.34, 2000). As a result, the parallel market contains higher-risk companies than does the official market (Al-Nefeesi, 2008). At present, the parallel market is best described as a transitory market where companies can list relatively easily prior to transferring to the official market.

Table 2. The Parallel Market: evolution of listing requirements

<i>Legislation</i>	<i>Capital requirement</i>	<i>Profit requirement</i>	<i>Other requirements</i>
Established 1984			-Only GCC companies admitted
Parallel Market suspended, 1988 (Annual Economic Report of the KSE 1988)			
Resolution No.6 (1989)	1 million KD	Not required	- Kuwaiti and GCC companies are admitted - At least two audited annual financial statements issued prior to listing - Shares traded based on book value or other value decided by the Market Committee - Company founders (vendors) retain 30% of their shares for two years
Parallel Market merged with the official market, 1993 (Resolution No.1 1993)			
Separate parallel market re-established, 2000 (Resolution No.4 2000)			

<i>Legislation</i>	<i>Capital requirement</i>	<i>Profit requirement</i>	<i>Other requirements</i>
Resolution No.34 (2000)	0.5 million KD	Not required	<ul style="list-style-type: none"> - Shareholders equity is at least 1 million KD - At least three audited annual financial statements issued prior listing - Minimum of 50 shareholders - Not more than 50% of shares at listing to be sold in the first year of listing
Resolution No.2 (2007)	3 million KD	Average profit must be at least 5% of paid-in-capital for the last two years, and company must have reported net profit during the previous two financial years	<ul style="list-style-type: none"> - Minimum of 50 shareholders - If a closed company has increased its capital by more than 50%, one year must pass from the date of notice in the commercial registry until listing - Non-Kuwaiti companies must be listed on their own domestic exchanges - Strategic shareholders must hold at least 25% of the company's capital, whether owned by one or more strategic shareholder - 50% of the strategic shareholders' shares cannot be sold in the first year of listing, 25% during the second year of listing - If a closed company has changed its legal structure, a period of three years must pass from the date of notice in the commercial registry before listing

5 Accounting and Auditing Requirements

An overview accounting and auditing standards and practices is provided in this section. The adoption of the International Financial Reporting Standards (IFRS) and the regulatory mechanisms for monitoring compliance with these are discussed next. The absence mandated auditing standards prior to the adoption of the International Standards of Audit (ISAs) in 2008 and the requirement for two auditors are discussed in section 5.2. The organisation of the accounting profession is then addressed in section 5.3.

5.1 Financial reporting standards and monitoring compliance

Kuwait is considered a pioneer not only among the GCC members,⁹ but also globally for its adoption of IFRS in 1991 (Al-Shammari *et al.*, 2008). Prior to the adoption of IFRS, however, the accounting standards used in Kuwait were most frequently based on those from the United States, members of the European Union, or other Arab countries (Elshamy and Al-Qenae, 2005; Shuaib, 1978; Shuaib, 1998). The accounting and disclosure practices chosen by companies varied widely, and the financial information disclosed was quite limited. Further, it was difficult to ascertain which accounting standards were being used by Kuwaiti companies (Al-Bannay, 2002). The lack of uniformity in the application of accounting standards made comparability between the accounts of companies difficult (Elshamy and Al-Qenae, 2005).

Since 1991, the compliance of listing companies with IFRS has been monitored by two agencies: the Control Department of the MoCI and the Surveillance Department of the KSE (Al-Bannay, 2002; Alanezi, 2006; Al-Shammari *et al.*, 2008). The Control Department of the MoCI is responsible for ascertaining compliance with the appropriate fiscal regulations and to verify compliance with IFRS (Al-Shammari *et al.*, 2008). Meeting the Control Department's mandate to monitor, review, and check IFRS compliance for every company in Kuwait appears to be unworkable given deficiencies of professional qualifications and the experience of the Control Department staff (Alanezi, 2006) and their high workloads (Al-Shammari *et al.*, 2008).

The Surveillance Department of the KSE is also legally responsible for monitoring the compliance of listed companies with IFRS. Unlike the Control Department, the Surveillance Department staff of the KSE are technically qualified and monitor compliance with a checklist to ensure all required disclosures are made (Al-Shammari *et al.*, 2007). Listed companies must submit their audited financial statements to the MoCI and the KSE within three months of the end of the financial year (Resolution No.16, 1987). The requirement for quarterly financial reports was introduced in 1998. These must also be filed with the MoCI and the KSE within 45 days of the quarter closing date (Al-Wazzan, 2006).

In general, the MoCI and the KSE are considered separate agencies. Each has its own procedures for determining compliance with IFRS. However, there is a lack of coordination between the two agencies and different enforcement mechanisms are applied by each (Al-Shammari *et al.*, 2008).

⁹ Oman adopted IFRS in 1986 (Al-Shammari *et al.*, 2008).

5.2 Auditing standards

No uniform body of regulated or even generally accepted auditing standards were used in Kuwait prior to 1998 (Shuaib, 1998). Most auditors voluntarily used the International Standards of Audit (ISAs), but there was no legal requirement to do so (Listing Consultants, Personal Communication, May 27, 2009). Some accounting firms based their audits on U.S. and U.K. standards while others did not appear to follow any particular standards. In some cases, financial statements were certified without any effective auditing (Shuaib, 1978; Shuaib, 1998). This eclectic approach to audits continued until 2008 when Ministerial Resolution No.101 required audits be conducted in accordance with ISAs. This resolution was clearly overdue when one considers that Resolution No.18, mandating the use of IFRS, was issued in 1990.

5.2.1 Auditor practice

Consistent with regulation in most markets, the Company Commercial Law (1960) required that listed companies be audited. Interestingly, Law No.51 (1994) mandated at least two auditors from separate firms serving as joint auditors for KSE listed companies. Both auditors must be independent of the company being audited and must be registered with the MoCI. Licensed auditors have been a requirement since 1981 (Law No.5). Licensed auditors are accountants who have passed the auditing practice professional examination (prepared by the MoCI in collaboration with Kuwait University), have a specified amount of audit experience, be Kuwaiti nationals and be registered with the MoCI. Registration of auditors, prior to Law No.5, required only a bachelors degree in business or, in some cases, practical experience only (Shuaib, 1978).

Even with the two auditor requirement for listed companies, it appears that auditors will authorize financial statements that do not reflect the true position of the company and questions about auditor conflict of interest are not uncommon. The apparent lack of auditor independence was highlighted by the Kuwaiti media as one potential cause that worsened the effect of the 2008 global financial crisis in Kuwait. As one Kuwaiti analyst put it, the “financial crisis is seen everywhere but in the financial reports of the Kuwaiti companies” (Al Mohasiboon Magazine, 2009a, p. 38). While the financial reports of Kuwaiti companies indicated their strength, the companies themselves were clearly under financial pressure.

The key legislation for the regulation of auditing in Kuwait is Law No.5 (1981). Law No.5 addresses the general requirements for registering and practicing accounting in Kuwait, the rights and duties of a public auditor, and the penalties that auditors may incur for violation of this law. This legislation

contains the conditions and procedures for auditor registration. It also forbids auditors from undertaking any additional professional activities that are incompatible with auditing duties including consultation unrelated to accounting, bookkeeping, and preparing financial statements or advertising services in a way that is incompatible with the ethics of the profession (Shuaib, 1998). Further, an auditor cannot also be a partner, administrator, employee, or a relative to anyone in the client’s company. Sanctions for violations of Law No.5 begin with a warning; proceed to prohibition from practicing auditing for a specific period of time; and end with removing the auditor’s name from the registry of auditors.

5.3 Accounting profession in Kuwait

The accounting profession in Kuwait is still in the early stages of development and is far from well established (Shuaib, 1998). The Kuwait Accountants and Auditors Association (KAAA), established in 1973, is the accountants’ professional body. The KAAA is a member of the International Federation of Accountants (IFAC). This body conducts studies, prepares research reports, provides consultations, promotes the exchange of experience, supports the development of members’ expertise, widens the practical background of those working in the field of accounting, and helps regulate auditors’ qualification exams (Kuwait Accountants and Auditors Association, 2010a). It does not, however, have the power to certify accountants and auditors or to set accounting and auditing standards (Al-Bannay, 2002; Alanezi, 2006; Shuaib, 1998). The KAAA has been criticized for its inability to set accounting standards, its inefficiency, and its slow progress as an accounting association (Shuaib, 1998).

To increase the effectiveness of the KAAA, Ministerial Resolution No., 291, which concerns the rules of ethical conduct for the auditing profession, was issued in 2006. This resolution charges the KAAA with monitoring the implementation of, and compliance with, ethical rules of conduct for accountants issued by the IFAC. It also gives the KAAA the right to investigate any violation of these rules of conduct and to report the complaint to the Minister of MoCI.

How effective the accounting profession has been with respect to the application of standards and the auditing of accounts is an open question. There have been numerous incidents where KSE-listed companies “bent” their application of required accounting principles to serve their own interests rather than those of stakeholders (Al-Bassam, 2006; Alanezi, 2006). The IMF (2004) highlighted the ambiguous and inadequate disclosure in financial statements prepared by some KSE-listed companies. Researchers, analysts, financial reporters, academics, and authors of specialized reports argue that the

accounting information provided by Kuwaiti firms would be enhanced by more stringent professional training for accountants (Al-Bassam, 2006; International Monetary Fund, 2004). They question the usefulness of the accounting information that KSE-listed companies provide investors and traders given relatively low levels of disclosure, a lack of reliability and the inadequate accounting expertise of preparers.

6 Implications for Research

The institutional setting in Kuwait has a number of implications for capital market based research. The regulatory framework and the types of investors who participate in the market result in informational inefficiency. Many theories in accounting and finance include the impact of variables on firm value and use price as the proxy for value. The validity of price as a proxy in this context relies on how much information is impounded in price and the speed at which this process occurs. While it is reasonable to assume that the trades of informed investors are responsible for setting security prices in developed markets, the profile of investors participating in the KSE provides an interesting context for identifying the factors that affect price setting when less sophisticated investors have a substantial role in the process. Small IPO sample sizes and weak form efficiency preclude typical underpricing studies. However, the listing requirements for the KSE provide several interesting research opportunities. These are discussed in the remainder of the paper.

6.1 Informational efficiency on the KSE

Antoniou *et al.* (1997) argue that the tests for market efficiency developed for highly liquid markets with strong participation by informed investors accessing frequent and reliable disclosures are not appropriate in the emerging market context. Investors in emerging markets may not meet the assumptions of rationality and risk aversion that underlie the efficient markets hypothesis (EMH) and, therefore, non-linear models of testing for efficiency are more appropriate for emerging markets (Antoniou *et al.*, 1997). While a number of studies show mixed results using linear tests of informational efficiency on the KSE, these will not be discussed here.

Hassan *et al.* (2003) use a non-linear approach and report that the KSE does not achieve the weak-form level of market efficiency. Therefore, the history of past prices for a stock is not fully reflected in the current price. Hassan *et al.* (2003) do, however, note that efficiency improves in the latter part of the 1990s. Also employing a non-linear approach, Abdmoula (2010) examines changes to the level of efficiency over time and concludes that the KSE is generally weak-form inefficient but that the level of efficiency varies across the sample period. He

contends that this variability in efficiency levels indicates that regulatory changes in Kuwait have not resulted in greater market efficiency (Abdmoula, 2010).

Research into the informational efficiency of the KSE indicates that, at best, the market is weak form efficient but may be weak form inefficient in different sample periods. Caution is advised for testing theories and models that require the assumption of an efficient market. For a security price to reflect the underlying value of the company, price must incorporate relevant information about the performance of the company and the market's assessment of prospects for future performance.

6.1.2 Share price and company value

A second requirement needed to justify the assumption that price is an unbiased representation of company value is that of insignificant arbitrage costs (Lee *et al.*, 1999). Short selling, which is a mechanism for arbitrage, is prohibited on the KSE (Hassan *et al.*, 2003; Aldaihani and Aldeehani, 2008). Further, KSE investors cannot create synthetic short positions as call options are the only exchange-traded derivatives and these are limited to companies approved by the Market Committee (Resolution No.337, 2004). Where arbitrage is not possible, as is the case on the KSE, prices will only incorporate the views of optimistic investors as pessimistic investors are unable to take short positions (Miller, 1977). This argument sits nicely with the KSE's history of speculative booms and busts.

Stiglitz (1989) advocates taxes to reduce speculative trading in stock markets and in markets (such as Australia) where capital gains tax is levied on stock market investments, a concessional rate is applied to investments held for more than one year. Kuwaiti investors do not pay tax (Global Consultants 2006) and this institutional feature may contribute to the level of speculation in the stock market.

The lack of effective arbitrage mechanisms combined with the relatively low levels of publicly available information (discussed in section 6.2) indicates that results from value relevance studies should be interpreted with caution. The impact of earnings management or accounting policy choice on price or return, for example, implicitly assumes that price reflects value. This assumption cannot be justified unless the market is at least semi-strong form efficient and the KSE has a way to go before this level of efficiency can be achieved.

6.1.3 Investor participation

Bley and Chen (2006) argue stock markets in the Middle East have remained virtually invisible to global investors. Restrictions that these markets have imposed on foreigners, their lack of common accounting standards, business transparency, and

economic and political uncertainty are features that foreign investors do not find attractive (Bley and Chen, 2006). With the exception of GCC citizens, the KSE was closed to international investors until 2000. The mean level of foreign investor shareholdings in Kuwaiti companies was around one percent in 2002 (Al-Shammari *et al.*, 2008). Further, the majority of traders (over 60%) on the KSE are individuals rather than institutional investors (Abdmoulah, 2010). Individual traders tend to be less informed, more subject to behavioural biases and face higher transaction costs (Masih *et al.*, 2010). Al-Shammari *et al.* (2008) confirm the dominance of individual investors on the KSE and their data show the mean level of institutional ownership in Kuwaiti companies is thirty-nine percent.

Al-Bassam (2006) contends that the volume of speculative trades on the KSE reduces the importance of accounting as an information source for investors. Given the informational inefficiency of the KSE, it is unlikely that investors could rationally expect to be rewarded for fundamental analysis as there is no demonstrated linkage between price and value. In their survey of Kuwaiti investor perceptions of information usefulness, Nasser *et al.* (2003) do find that investor groups rate financial statements as an important source of information. However, the financial statements rate after 'other information obtained directly from the company' for individual investors, while stock market brokers rate market rumours as more important than financial statements (Nasser *et al.*, 2003). They argue that the importance of rumour can be attributed, in part, to the fact that brokers and institutional investors spend their working days in the exchange building.

The capacity for market manipulation is enhanced where rumours are regarded as a primary source of information. Both market manipulation and insider trading are serious problems on the KSE (International Monetary Fund, 2004). In Kuwait, Board members cannot be held accountable for selectively 'sharing' confidential information which has the capacity to affect share prices and trading volume (Kuwait Transparency Association Report, 2006). Foreign investors will not find the KSE an attractive opportunity for diversification if their investment is likely to result in a transfer of their wealth to corporate insiders. The number of informed investors is, therefore, constrained by the characteristics of the KSE.

The KSE provides an excellent context for testing functional fixation on accounting information releases (c.f. Kaplan and Roll, 1972; Hand, 1990). We would expect that a large pool of relatively unsophisticated investors using accounting information would be fooled by cosmetic changes in the financial statements. The importance of rumour as source of information, however, provides a potentially confounding variable if a negative (or positive) rumour is circulating when a profit

increasing (decreasing) accounting change is announced. A mixed methods approach using quantitative analysis of stock prices and accounting announcements and qualitative analysis with brokers at the exchange could resolve the issue.

6.2 Information availability

Non-disclosure is considered a key deficiency of the KSE. To provide transparency for stakeholders, information that affects the financial position of a company must be disclosed through appropriate official and legal channels then be released to the market in a timely fashion. While disclosure of legal disputes, for example, is mandated for KSE listed companies it has become standard practice for the KSE regulators and other stakeholders to read such information in the media prior to its official disclosed (Kuwait Transparency Association Report, 2006). As a result, shareholders may receive vital financial information only after the share price has changed and deals have been completed by insiders (Al-Nefeesi, 2008). The injunction issued against Mobile Telecommunication Company (MTC) (now Zain) on April 19, 2006 (Kuwait Transparency Association Report, 2006, p. 13) provides an example. MTC did not disclose the injunction to the KSE so the exchange could not disseminate the information. Investors were astonished when the verdict from the case was published in newspapers several weeks later. MTC shares were not subject to a trading halt and ensuing trades allowed insiders to profit from trading on the undisclosed information.

Without the enforcement of continuous disclosure requirements for the KSE, researchers will experience difficulty determining when specific pieces of information became available to market participants. This feature has serious implications for research questions that are typically answered with an events study methodology – determination of 'event' dates would necessarily be arbitrary. While the KSE has embraced an electronic trading system, the electronic dissemination of information to market participants lags well behind that observed in developed markets. Announcements arising from continuous disclosure requirements are released on the KSE announcement board for the benefit of investors in the exchange building but are not stored on the KSE website.

The KSE began provide annual reports for listed companies electronically in 2008. Prior to this date, the majority of annual reports were available only in hardcopy and had limited distribution. The sampling timeframe for value relevance research would necessarily be constrained to the post 2008 period. It would require a heroic leap of faith to assume that information in the financial statements had been 'instantaneously' available to the market prior to 2008. However, Kuwaiti companies willingly supply

annual reports when requested (Nasser *et al.*, 2003; Al-Shammari and Al-Sultan, 2010).

6.3 Listing companies

As discussed in section 3, the majority of new listings on the KSE are KSCCs that do not list to raise new capital and shares are offered at book value or 'other approved' value. Therefore, there is little capacity for IPO underpricing studies given the very small sample sizes. Listing companies make hard copy prospectuses available in the exchange on listing day. Prospective investors wishing to purchase shares on the first trading day would be subject to extreme information asymmetry as they would have very limited time to process the prospectus information. In addition, the somewhat arbitrary nature of the application of listing requirements was flagged as a major issue in the Kuwait Transparency Association Report (2006). The Market Committee has approved companies that do not meet the listing requirements for admission and it is difficult to see how the prospective investors could identify such occurrences given the short time they have to analyse prospectus data for trading on listing day.

The two auditor requirement of Law No.51 (1981) applies only to the financial statements of listed companies, not to those seeking admission to the list. Thus, for the historical financial statements presented in prospectuses, it would be prudent to spend more rather than less time analysing this information. By implication, the two auditor requirement suggests that a single auditor is insufficient in the Kuwaiti context. This feature casts doubt on the usefulness of pre-listing financial statements and provides scope for further research.

The introduction of lock-up restrictions and changes to these outlined in section 4.1.1 provide an exciting opportunity for listing company research in Kuwait. While extant research indicates weak-form inefficiency on the KSE, investigation of trading volumes at lock-up expiration may provide insights for the use of signalling by founders in the post-listing period. The frequent changes to the pre-listing profit and capital requirements provide opportunities for research to test the efficacy of these regulations. One interesting empirical question would be 'do listing companies that meet the profit requirements in periods when these are more stringent perform better in the long run?'

6.4 Incoherent regulatory framework

The Kuwaiti regulators continue to promulgate regulations that do not meet the standard required for ISOCO membership (Bouresli, 2009). The Market Committee, MoCI, and CBK have issued a large number of regulations over the last three decades and these are difficult to track. Although the KSE website includes some regulations, administrative decisions,

and guidelines, investors and researchers will have difficulty grasping the implications of these brief publications which are not clearly explained. This lack of clarity became painfully clear to the authors of this paper as we tried to collate and interpret the regulations governing the KSE across time. Therefore, we expect the summary of regulations provided in this paper will ease the path for those interested in capital market research in the Kuwaiti context.

In conclusion, theories based on the efficient markets hypothesis will be less able to explain changes in share prices in the Kuwaiti setting. While this constrains the application of some theories, institutional features offer opportunities for research that could not be conducted in other markets. The importance of individual investors in price setting and the information they can access when making investment decisions suggests tests of behavioural theories as a potentially fruitful area for future research using KSE data.

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