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Bidirectional Relationship Between Cash Holdings and Financial Performance for Banks in the MENA Region

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ABSTRACT

This study examines the interrelationship between cash holdings and financial performance by firstly investigating whether the existence of an optimal cash level maximizes financial performance and secondly measuring the impacts of financial performance over the optimal level of cash holdings. This study uses a sample of 400 financial institutions in the Middle East and North Africa (MENA) region across 18 different countries over 15 years (2003–2017). The results support the hypothesis about the positive impact of cash holdings over the financial performance as well a positive influence for financial performance over the existence of an optimum level of cash holding. The analysis supports this association through a robustness test by controlling the culture variables based on Hofstede's model as well as through using different alternative measures for cash holdings. This study is one of the original empirical studies that measure the interrelationship between holding cash and the level of financial performance through the banking sector in the MENA context.

KEYWORDS

Bi-Direction Association, Cash Holdings, Culture and MENA Region, Financial Performance

1. INTRODUCTION

The issue of cash holdings by corporate enterprises has received growing attention in accounting and finance literature due to its consequences on the value of firms (Martinez-Sola et al., 2013; Amess et al., 2015).Most of the existing research on this topic is in the context of developed countries, such as the US, with rare attention given to developing markets (Guizani, 2017). This study seeks to measure the two-direction association between cash holding levels and financial performance (FP) by examining a large sample of banks that operate in the Middle East and North Africa (MENA) region.

Businesses have knowingly extended their cash holding levels over recent decades. Deloitte states that "The highest 1000 non-financial multinationals are holding $2.8 trillion in cash". Forbes estimates the cash holdings by wholly-owned US companies alone are measured to be $5 trillion. The cash holdings of US businesses from the 1990s to 2000s, histrionically augmented to about 13% of total assets for businesses, adds up to 10% of yearly US GDP (Dittmar and Mahrt-Smith, 2007). Furthermore, cash holding levels grew by 0.46% per year over the 1980–2006 periods (Bates et al., 2009). While Gao et al (2013) find that public corporates in the US market keep on average 18.8% of their assets in cash and cash equivalent, significant cash holdings are not kept only in the US context. Japanese businesses, for example, held $2.1 trillion in cash which equals 44% of Japan's GDP.

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Equivalent statistics for Korean businesses are $440 billion which represent 34% of Korea's GDP. Based on research by Ferreira and Vilela (2004), European companies held 15% of their total assets in cash at the beginning of the 2000s; whereas Chinese firms held more than 20% (Chen et al., 2012). Other studies (Foley et al., 2007 and Mello et al., 2008) have shown the proportion of cash holdings ton assets ranges between 8% and 10.5%. The numbers above prove that holding cash is important for corporate enterprises and studies have begun to explore its consequences and benefits for businesses.

Holding cash balances has several consequences. One of these is the benefit of improving a business's FP. The degree of cash holdings contributes to a corporation's survival and has played a significant role in avoiding recent financial crises. Businesses with a significant amount of cash managed to withstand the downturn and, therefore, have less need to borrow. Conversely, many businesses with lower cash holdings need to re-finance, either through liability or equity, even at a higher cost of capital. Previous studies such as Lee and Lee (2009) examined the influence of holding cash on the value of business and found that Tobin's-Q is negatively influenced by cash holding. The results showed that businesses with significant levels of cash holdings cause shareholders concern that managers may waste resources on investment that impacts a business's value. However, Kalcheva and Lins (2007) concluded that cash holding has a positive influence on a firm's value. Srinivasan (2014) also supports the result of a positive impact of cash holding on the FP. Such mixed results as well as, to our knowledge, the absence of studies that examine the effect of a bidirectional relationship between the cash holdings of banks and FP in developing regions such as MENA highlight the importance of the current study.

Our sample consists of 400 banks across the Middle East and North African (MENA) markets. Several reasons justify this focus. Firstly, because these countries are incorporated into the European Union's neighbourhood policy, they share a distinctive economic improvement trajectory although they reflect diverse dimensions of development and financial modification. Therefore, studying MENA countries provides a rich ground for relative analysis linking cash holdings and FP. Secondly, the MENA region, and especially Gulf Cooperation Council (GCC) countries, average 60% of investment in Islamic banks, although studies measuring cash holdings in this region with these banks are rare. Therefore, this study covers a large sample of banks, including an average of 100 Islamic banks. Thirdly, several academic researchers have focused on cash holdings in other developing countries, while FP and cash holdings for the banking sector in the MENA region have been ignored. For example, in their global sample of 45 countries, Dittmar et al (2003) include only Egypt and Jordan from MENA. Al-Najjar and Clark (2017) incorporate nine countries out of 19 MENA countries, while Ramirez and Tadesse (2009) include just Egypt in their study. Guizani (2017) focuses on only one country from the GCC, namely the Kingdom of Saudi Arabia (KSA). Otherwise, to the best of our knowledge, there is no other evidence of studies on cash holdings and FP for financial institutions in the MENA countries.

The current study differs from previous studies for several reasons. While we focus on developing and multi-countries, other studies, such as Cristina et al. (2013), measure the effect of cash holdings on a firm's value using a sample of US industrial firms. Maurizio et al. (2018) measure the association between cash holdings and FP in one country, Italy, while our study examines this link across multi-countries. Moreover, Choonsikl and Park (2016) examine whether board governance plays a role in lowering agency concerns around corporate cash holdings; while our study examines whether the FP plays an important role in developing the level of cash holdings. Furthermore, Masood and Shah (2014) and Ohannes et al (2010) measure the relationship between corporate cash holdings and corporate governance variables testing non-financial firms across Pakistan and China with India; while our study examines the association between FP and cash holdings in the financial/banking sector. Similarly, Tarik and Ercan (2017) examine the value of cash holdings in the hotel industry, while this study examines the value of cash holdings in financial institutions. Adrian (2016) and Ester et al. (2016) examine to what extent corporate social responsibility may affect corporate cash holdings, while our study examines to what extent FP may affect corporate cash holdings.