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Funding and Financial Performance of Private Higher Education Institutions in Kuwait

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I. Introduction

Financial monitoring and accountability of higher education institutions has always been an issue of concern in many countries. The voluminous research output on this issue testifies to its importance to the public and regulatory authorities, as well as other stakeholders, to be aware of: (i) what these institutions are doing; (ii) why they are doing it, and (iii) whether they are doing it well (CAUT, 1993). In the United States, the Governmental Accounting Standards Board (GASB, 1987) states accountability as the paramount objective from which all other objectives must flow. In the UK, the publication of the Statement of Recommended Practice for Accounting in UK Universities provides the bridge from decision-making to accountability in these institutions (CVCP, 1989). Recent literature included several studies on accountability of tertiary education institutions in different countries worldwide (Banks *et. al.* 2004).

Notwithstanding, the issue of financial monitoring and accountability has been dealing, to a large extent, with not-for-profit public or private institutions; however, the issue is also of vital concern to other degree-granting, for-profit institutions. For-profit educational institutions are relatively recent phenomena (Geiger, 1986). The University of Phoenix, the biggest provider in the US commenced operations in 1998 and had enrolled over 150,000 students by 2004. These providers are the fastest growing academic institutions with their parent companies often listed in the common stock market and are the most troublesome for regulators. A lawsuit filed in 2004 accused the University of Phoenix of providing recruiters with incentives to enrol unqualified students, a case that Phoenix University settled for US$ 9.8 million (Phillips, 2007). The mechanism and procedure for financial monitoring may not be identical for diverse types of educational institutions, but the inherent need and objective is essentially to assure the stakeholders of the well-being of the institution, and the degree of economy, efficiency, and effectiveness by which it manages the resources available to achieve its mission and objectives.

There are several groups of stakeholders which have interest in the financial well-being of higher education institutions, whether public or private, for-profit or not-for-profit such as: regulatory agencies, licensing officials, accreditation agencies, equity owners whether present or potential – in the case of for-profit institutions – funding and other financial resource providers (e.g. donors), recipients of institutions' services (students and their parents), faculty members and administrators, as well as the public at large.

Financial reporting represents an essential means of providing stakeholders with information about higher education institutions' activities, and provides a basis for informed judgment and decision-making (Engstrom, 1988). In the next section, a general model for financial monitoring and accountability of private higher education institutions is outlined, based on the information generally available in periodic (annual) financial reports prepared and communicated by each institution to interested parties, particularly regulatory agencies. The model provides a detailed description of the components of financial reporting analysis for the purpose of financial monitoring with respect to universities and other higher educational institutions. This model will be used as a basis for assessing the financial performance of private institutions of higher education in Kuwait which are subject to Law 34/2000 for Private Universities. The result of assessment will be used as a basis for policy decisions taken by the Private Universities Council (PUC) in Kuwait, which represents the regulatory body for these entities (Al-Atiqi *et al.*, 2004).

II. Sources of funding

1. *Paid-in capital*: most educational providers in Kuwait are owned by registered corporations. Law 34/2000 stipulates that founder's equity for private institutions must have a local (citizens) majority. This equity is determined at the time of license application within the feasibility and financial study. The ample availability of funds within the local private sector enables most institutions to be founded without the need for foreign capital. *Table 1* below lists the founder's equity for the operating institutions.

Table 1. Private higher education institutions in Kuwait, paid-in capital according to Licensing Decree

Private higher education institutions	KWD'000	Year licensed
Gulf University for Science & Technology (GUST)	10,000	2002
American University of Kuwait (AUK)	1,000	2003
Australian College of Kuwait (AKC)	1,900	2003
Kuwait-Maastricht Business School (KMBS)	200	2003
Arab Open University (AOU)	(not applicable)	2002

2. *Loan facilities*: Kuwait has an advanced banking system that can be tapped to supplement owner's capital. Current licensing procedures allow for loan facilities

to a limited extent, typically not exceeding owner’s equity. Inspection of common-size financial statements for operating institutions reveal that total liabilities amount to 42 per cent of total assets, of which 30 per cent are current liabilities.

3. *Enrolment fees*: Most institutions charge students on a credit-hour basis. This would range between KWD 130-170 per credit and students register in a semester-based system with 12-18 credits per semester. The tuition fees are a major source of revenue for institutions that allow for operating expenses coverage as well as future expansion. Tuition fees are agreed upon during license application. The Private Universities Council (PUC) allows for a reasonable fee structure that is compatible with the standard of living. The enrolment data proves that society accepts the current fee levels, alongside enrolments that match up with, to a reasonable degree, feasibility study expectations. Further elaboration will be made later on in the paper. The fee structure is not allowed to increase before a lapse of five years.

4. *The Offset Programme*: This programme was established in 1992 by the Kuwaiti Government. It is defined as the derivation of particular financial commitments from foreign companies and agencies that provide imported goods and services to the Government of Kuwait. Under the Offset Programme foreign companies which wish to sign supply contracts of a value equal or greater than KWD 1 million with the Government of Kuwait are required to invest, inside or outside of the state, in projects adding value to the national economy. Under this programme, the offset obligation is equal to 30 per cent of the contract value to be executed within eight years of the contract award. As an incentive to invest in counter-trade offset obligations, the Government sets a multiplier for certain developmental projects in order to lower the offset burden. A three multiplier means that a contractor can invest KWD 1 million and obtain credit for KWD 3 millions; the multiplier for educational projects being typically 3.5. Certain academic institutions have benefited greatly from the Offset Programme. One institution has obtained major engineering, aviation and marine science equipments from offset obligations, valued at more than KWD 12 million. The

audited results of this provider shows that the offset grant constituted 24 per cent of its total asset in 2006. With this programme, they were able to develop a major expansion from a diploma programme to a Bachelor of Technology Programme. The Offset Programme is also a major provider of student scholarships for students to pursue their tertiary education. This activity is a result of an agreement with the Ministry of Higher Education (MOHE).

5. *Interstate funding programmes*: There are numerous funding programmes of this type whether related to trust foundations or to UN organizations. The programme that made the largest impact in Kuwait and many Arab States is the Gulf Programme for Support of United Nations Developmental Agencies (AGFUND). Chaired by Prince Talal bin Abdul Aziz Al-Suood, this programme established the Arab Open University (AOU) in 2001. The AOU was housed in Kuwait by an agreement with the Government and has now branches in more than seven Arab countries. This agreement was ratified as Law 31/2002 in the State of Kuwait. In Kuwait itself, more than 6,000 students are currently enrolled in the AOU Kuwait branch with a tuition fee that is roughly KWD 500 per year. UNESCO has signed an agreement with the AOU Chairperson in October 2001 to provide information and communication technologies (ICTs) equipment and personnel training to the University. This will include video conferencing equipment and satellite linkages for distant education and electronic library. The project value was US$ 1.55 million.

6. *Government facilities*: Several Government programmes are in place for direct and indirect support of private universities. A crucial one is the land grant facility. An agreement was reached with the Ministry of Finance (MOF) and the municipality to allow private institutions to sign long-term leases on state lands for their campuses. In a compact country like Kuwait, this facility proved very beneficial. Other programmes of interest are the scholarships granted by several Government agencies for their employees to study in private institutions. These programmes supplemented institutions with additional sources of revenue following the self-paying students. The biggest programme of this kind is the scholarships of fresh high school graduates which started this year. The PUC

secretariat negotiated with the Ministry of Finance a budget of KWD 3.4 million for support of 1,068 students in 2006/07 which constituted 80 per cent of the tuition cost. The purpose of this programme is fair access to otherwise limited tertiary education seats within the country. Not directed to institutional funding, this programme is partially supported by the institutions themselves in terms of subsidized tuition. It is to be noted in this context that all institutions achieved profitable status before this programme commenced.

III. Tools of analysis

There exists a rich source of references on financial reporting analysis (Palepu, Healy and Bernard, 2004; Wild, Suramanyam and Halsey, 2007), as well as its application to educational institutions (KPMG, 1999; Lane *et al.*, 1987; Moody's Investors Service, 1999; Peat Marwick International (PMI); Mitchell & Co., 1982; Fischer *el al.,* 2003). A brief description of each of the analysis tools referred to in the model is outlined as follows:

IV. Economic analysis of industry

Analyzing a private education institution's viability and sustainability requires first to assess the potential of the educational sector in which the institution is competing (i.e. its industry). Analysis of the industry and its structure is influenced by the degree of actual and potential competition among institutions operating in the industry, as well as the bargaining power of suppliers of services (universities and other higher education institutions) and buyers of services (demand for higher education).

Factors affecting the degree of competition include population growth and demand for higher education, the number of institutions offering educational services, their capacity and types of degree programmes they are offering, the threat of new institutions entering the industry and potential effect on market share.

Analysis of bargaining power of suppliers and recipients of educational services entails assessing the quality of education offered, the cost of providing the service, the type of degree programmes offered by the institutions and their viability in the job market for graduates.

V. Competitive strategy analysis

The economic viability of the education institution is influenced not only by its industry structure but also by its vision and mission, the strategic choices it makes and its success at establishing a competitive advantage as well as the sustainability of its competitive advantage. Assuring quality of educational programmes offered by the institution through accreditation, and ensuring continuous improvements in these programmes to meet the changing demand by the job market. A strategy is undertaken by the education institution to differentiate its products from those offered by its rival institutions. Another strategy which may be followed by the institution is achieving cost-effectiveness in providing its services to students.

VI. Accounting analysis

Administrators of private higher education institutions are subject to accountability to the governing body of each institution (Board of Trustees) as well as to the regulatory bodies responsible for monitoring private educational services at the national level (e.g. the Private Universities Council).

- The institution should maintain an information system capable of providing the required information in the most efficient and effective manner in order to discharge its responsibility to stakeholders.

- Financial reports prepared annually by the institution are subject to scrutiny and analysis by regulatory bodies.
- Analysis of financial reports is a process of evaluating the extent to which financial data presented reflect economic reality.
- Auditing of financial statements prepared by the institution by an external independent auditor ensures the verification of the integrity of the reported accounting figures and ensures that management use the proper accounting methods and estimates in accordance with generally accepted accounting principles.
- Accounting analysis includes evaluation of the quality of accounting numbers appearing in the financial statements and its freedom from distortion of economic reality, appropriate disclosure to ensure integrity, reliability and relevance of information. It also includes evaluation of earning power and its sustainability.
- Assessing the financial viability and sustainability of the education institution may require information beyond those normally disclosed in financial statements. Therefore, accounting analysis may be extended to ensure that the necessary additional information for this purpose is duly, and timely, provided for by the institution.

VII. Financial analysis

The goal of financial analysis is to assess the performance of the institution, and its achievement of goals and strategies, through utilization of resources available at its disposal. Ratio analysis and cash flow analysis represent the main tools for financial analysis.

Financial analysis consists of an assessment in two broad areas (i) Profitability (Return) Analysis, and (ii) Risk Analysis. Financial analysis of past and present performances provides a good foundation for making forecasts of future performances.

Ratios and cash flow analysis provide useful tools for assessing the institution's achievements as a result of its strategies, policies and decisions in the three broad areas of *operating activities*, *investing activities* and *financing activities*. Profitability (Return)

Analysis focuses on identifying, measuring, and evaluating the impact of various profitability drivers, usually in terms of the institution's return on investments and its components and its ability to generate adequate return from operations. It also focuses on reasons for changes in profitability and its sustainability. Risk analysis is the evaluation of the institution's ability to meet its commitments, whether in the short-term (Liquidity) or in the long-term (Solvency). Risk analysis involves assessing earnings variability in face of change in the demand for the institution's services (Operating Risk) or as a result of its capital structure which determines the sources of finance (Financial or Credit Risk).

The use of financial ratios to assess risk and return characteristics of the institution involves comparison over time (time-series analysis), and with other institutions and benchmarking (cross-sectional analysis).

VIII. Prospective analysis

Prospective analysis is the use of (i) strategy analysis; (ii) accounting analysis and (iii) financial analysis in prediction of future performance. Regulatory agencies in the educational sector emphasize accountability and financial stability of the education institution. Therefore, they assess earnings sustainability and growth expectation in order to meet variability in demand (number of students admitted). It is also of interest to regulatory agencies to forecast the ability to self-finance growth in the institution's services by relying on internal sources of finance, i.e. earnings retention and growth in its net assets.

Owners of private, for-profit institutions focus on the ability to create value to owners in terms of earnings and cash flows and their effect on the institution's economic value (usually market value). Forecasted figures for earnings and cash flows provide basis for estimating value.

IX. Application of the Financial Performance Model to private higher education institutions in Kuwait

A total of five higher education institutions were granted licenses to provide degree-programme educational services in Kuwait in accordance with the Law of Private University (Law 34/2000-Kuwait), the:

1. Gulf University for Science and Technology (GUST).
2. American University of Kuwait (AUK).
3. Australian College of Kuwait (ACK).
4. Kuwait-Maastricht Business School (KMBS).
5. Arab Open University (AOU).

The ownership structure of these private universities and net capital investments as of the end of the Fiscal Year 2005/06 appears in *Table 2.*

a. Financial data for each of the private institution is taken into consideration and extracted from the audited annual financial report prepared by the institution since inception (income statement, balance sheet, and statement of cash flows).

b. A common size income statement and balance sheet for each year are prepared. **Operating Revenues** being the deflator factor for all items in the income statement, and each item of assets and liabilities and owners' equity is presented as a percentage of **Total Assets**.

Table 2. Ownership structure of private higher education institutions in Kuwait as end of Financial Year 2006

Private higher education institutions	Ownership structure	Owners' equity KWD.'000
A	Wholly owned by a listed corporation.	4,666
B	Wholly owned by a listed corporation.	1,292
	A branch of a limited liability company which	754

C	is a subsidiary of a Kuwaiti closed corporation.	
D)	Wholly owned by a limited liability company.	793
E	A branch of an independent, not-for-profit Arab institution for education.	(not applicable)

c. Financial Ratio Analysis (see combined statistics in *Table 3* below).

The following ratios were computed for the purpose of assessing annual performance in the area of:

Activity Analysis:

(1) Total Asset Turnover = Operating Revenues/Total Assets;

It is a measure of the efficiency of using total resources available to generate revenues.

(2) Expenses coverage from owners' equity = Owners' equity/total expenses.

It is a measure of the extent of meeting annual expenses by reliance on funds provided by owners.

Liquidity analysis:

(3) Current Ratio = Current Assets/Current Liabilities.

It is a measure of the ability to meet short-term obligations from current assets.

(4) Cash to average daily expense = Cash Balance/Total cash expenses/365.

It measures the number of days that available cash covers daily cash expenses.

(5) Cash to Total Cash Expenses = Cash Balance/Total Cash Expense.

Measures cash coverage of expenses.

(6) Operating Cash Flows to Current Liabilities = Operating Cash Flows/Current Liabilities.

A measure of ability to meet short-term obligation using cash generated from operating activities.

Solvency analysis:

(7) Debt to Total Assets = Total Liabilities/Total Assets.

Measures the extent of financing total assets from debt financing.

(8) Operating Cash Flows to Total Liabilities = Operating cash flows/total liabilities.

Measures the ability to settle total debts from cash generated from operating activities.

Profitability analysis:

(9) Net Profit Margin = Net Income/Operating Revenues.

A measure of profitability from common-size income statements.

(10) Return on Total Assets = Operating Income/Total Assets.

A measure of return on investment, irrespective of sources of finance.

(11) Return on Equity = Net Income/Total Owners' Equity.

Measures return on investment by owners.

(End of year value is used for balance sheet items instead of average when related to income statement items or cash flow items in order to have, at least, financial ratios for consecutive years).

Table 3. (a) Financial ratio analysis from combined financial data of all private higher education institutions

Financial ratio analysis	**2004**	**2005**	**2006**	**2004-2006**
Activity analysis:				
(1)Total Asset Turnover = Operating Revenues/Total Assets	1,03	1,14	1,07	1,07
(2)Expense coverage from Owners' Equity = Owners' Equity/Total Expenses.	0,58	0,64	0,63	0,62
Liquidity analysis:				
(3)Current Ratio = Current				

Assets/ Current Liabilities	0,55	0,84	1,05	0,79
(4)Cash to Average Daily Expense = Cash Balance/(Total Cash Expense /365)	19,9	16,2	48,2	29,8
(5)Cash to Total Cash Expenses = Cash Balance/ Total Cash Expense	0,05	0,04	0,13	0,08
(6) Operating Cash Flows to Current Liabilities = Operating Cash Flows /Current Liabilities	0,92	1,09	1,55	1,18
Solvency analysis:				
(7) Debt to Total Assets = Total Liabilities/Total Assets	0,5	0,27	0,45	0,42
(8) Operating Cash Flows to Total Liabilities = Operating Cash Flows/Total Liabilities	0,73	0,93	0,88	0,83
Profitability analysis:				
(9) Net Profit Margin = Net Income/Operating Revenues.	17,80%	0,10%	18,30%	13,20%
(10) Return on Total Assets = Operating Income/Total Assets.	16,60%	- 0,20%	19,00%	13,30%
(11) Return on Equity = Net Income/Total Owners' Equity	36,90%	0,20%	35,30%	24,40%

Table 3. (cont'd) (b) Common size financial statements from combined data of all institutions for the period 2004-05

Income statement:	
- Operating revenues	100
- Operating expenses	88
- Operating income	12
- Net income	13
Balance sheet:	
- Current assets	23
- Non-current assets	77
TOTAL Assets	**100**
Current liabilities	30
Long-term liabilities	12
TOTAL Liabilities	**42**
Owners' equity	58

d. Financial statement items for all institutions were combined and used as a basis of computing combined common-size income statement and combined common-size balance sheet for all institutions, averaged over the years 2004-06. Combined financial statements for each year were used to compute financial ratios for the whole sector of private higher education institution in Kuwait, for each of the Fiscal Years ending 31 August i.e. 2004, 2005, 2006 (With the exception of AOU which has a calendar year ending 31 December). The combined statistics appear in the above *Table 3(a-b)*).

Analysis of strategy:

Each institution, for the purpose of applying for a license to the PUC, is required to submit a detailed technical and economic feasibility study, in order to demonstrate the economic and financial viability of the project. Economic feasibility entails preparation of a detailed market study which projects the demand expected for each degree programme proposed by founders. The proposed plan for the institution is subjected to a careful analysis by the PUC through its standing committees before granting approval. The following observations pertaining to strategy analysis of the five private institutions now operating in Kuwait are presented below:

(a) Based on recent market studies for higher education in Kuwait, it is noticeable that the gap between *supply* from existing institutions, public or private, and *total demand* by high school graduates *justifies the founding of private institutions*. The gap is widening over time due to demographical factors.

(b) Programmes of study currently offered by private institutions tend to be concentrated in areas of liberal arts, business administration, and computer science and technology.

(c) Quality Assurance (QA) of degree programmes offered by private institutions is assured through the requirement imposed by the PUC for institutional accreditation within two years of the starting date, and the requirement for licensing of having a plan for programme accreditation by relevant internationally recognized agencies. Some institutions plan additional institutional accreditation from international accrediting agencies.

(d) Association with a reputed university on an affiliation bases through a joint degree agreement, or operating as a branch represents a strategy by private institutions for creating a product differentiation, and is thus considered as a market strategy. Operating as a branch of a foreign internationally recognized university gives private institutions the advantage of granting their graduates internationally recognized qualifications, thus enhance the demand on its educational services – notably the case of the Kuwait-Maastricht Business School (KMBS).

(e) Analysis of the fee structure of private institutions indicates that the variation in pricing educational services is limited (tuition fees per credit hour is around KWD 130-160 for undergraduate degree programmes). This suggests that private institutions in Kuwait did not consider so far pricing of services as a strategic tool for attracting students.

(f) It is noticeable that private institutions, by concentrating on liberal arts and business studies programmes in degree offerings, to their students, may reflect the strategy by these institutions to avoid the need for investing and providing finance for establishing degrees in engineering and medical sciences and similar programmes which require relatively high costs.

Accounting analysis:

Private universities and colleges in Kuwait are required by Law 34/2000 and its Executive by-laws to have its annual financial report audited by an external auditor, and approved for release by the Board of Trustees of each institution. All financial reporting for Kuwaiti firms should be prepared in accordance with international accounting standards. External auditing is conducted according to international auditing standards by professionally- qualified auditors. The following are observations regarding the financial reporting by private institutions:

(a) Financial statements for the institution, as an entity separate from its parent company or headquarters are usually extracted from the financial records of the parent company or headquarters, and in some cases without having a separate set of accounting records in accordance with generally accepted accounting principles. This phenomenon was diminished in later years after intervention of the PUC towards more autonomy in the financial records.

(b) Inter-company transactions among the institution and its parent company or headquarters tend to be priced on the basis of management estimates and internal transfer pricing, without full disclosure of these bases, and usually without reference to the approval by the Board of Trustees. The effect of these transactions on income statement and balance are significant in most cases. This may be related to the fact that the parent company is the one responsible on land grant management and contracting. The PUC took action to resolve this situation in the near future.

(c) Although the by-laws and accountability rules set forth by the PUC clearly establish the importance of the role of the Board of Trustees in planning and approving dividend policy by the institution (or the management of fund transfer in the case of not-for-profit institutions such as AOU), financial reporting by institutions gives little in the way of disclosing these policies and the bases for transfer of funds among the institutions and their headquarters. This reflects a light touch monitoring on the part of the PUC.

(d) The accruals (differences between cash flows and accrual basis) regarding expense and revenue items play a limited role in the case of educational institutions in general (with the exception of depreciation and amortization charges for institutions with relatively high investments in plant assets and intangibles). This suggests that management manipulation of earnings measures through accruals is at minimum in the case of these institutions, and thus a higher quality of earnings.

(e) Disclosure of information in financial reports, though it follows international accounting standards, does not cover areas of significant importance in analyzing financial statements of educational institutions.

A notable example is lack of details on cost items necessary to assess performance of the institutions in areas such as research and community services as well as detailed costs per each educational programme. Average revenue generated per each faculty member is another example which cannot be measured directly from financial reports. Most of data needed for this purpose are available from the internal information system of the institution if it is separately maintained, as well as from budgetary planning and control systems if properly maintained. This suggests that the PUC, as the regulatory and governing agency may seek to reinforce its accountability and governance rules through additional disclosure requirements from private institutions.

Financial analysis:

We may draw the following observations on the basis of financial statements of private institutions during the period of 2004-06, and financial ratios as shown in the aforementioned *Table 3 (a-b):*

(1) In *Table 4* we compare average accounting returns actually achieved by each institution by the relevant return figure expected at time of licensing in its financial feasibility study. It is noticeable (with one exception) that private institutions manage to achieve a higher return than they expected in early years of operations. Taking into consideration the typical profitability profile for similar institutions in the first (introductory) stage of their product-life cycle, which usually exhibits a negative return,

private institutions managed to achieve better than expected in terms of profitability (more noticeable in the case provider of the Arab Open University (AOU) in its first few years of operation, due to the lower base of investment). Profitability figures for the net income margin, return on assets and return on equity, shows an increasing pattern which may shed light on expected profitability in future periods. The noticeable drop in return measures in the second year of operation for most institutions may be related to the need for compliance with several governance rules stipulated by the PUC, particularly in the course of institution accreditation, which may have resulted in incurring additional costs (e.g. hiring additional faculty members or adding more facilities). This suggests that compliance and strengthened governance rules by the PUC have a direct effect on the profitability profile of private institutions.

Table 4. Assessment of financial performance of private higher education institutions in Kuwait, 2006-06

Expected *versus* Actual Profitability Average for the first three years of operations
[as measured by the Average Accounting Rate-of-Return (ARR)]

Private higher education institutions	Expected ARR (percentages)	Actual ARR (percentages)
A	15%	26%
B	-22%	-13.8%
C	19%	-28%
D	0.5%	5.3%
E	20%	128%

(2) Analysis of liquidity for private institutions, individually and collectively, reflects a weak liquidity position and an above-average liquidity risk. The liquidity measures, both on accrual basis and cash basis, reflects the lack of enough cash and near cash assets to meet short-term obligations. On the other hand the trend in liquidity is rising in general from one year to another. This probably results from the monitoring process by the PUC through reviewing annual financial performance, and the move on the part of institutions

to comply with requirements imposed through institutional accreditation process by the PUC.

(3) Asset structures, as reflected in the common-size balance sheets, show that on average 77 per cent of total assets are invested in non-current assets. Most private institutions so far are operating in temporary buildings, until they move to permanent cites which are currently under construction. Non-current asset figures include investment in constructions in progress. It is noticeable also that most institutions elected to capitalize pre-operating costs and some intangibles, the costs which are being amortized over a limited number of years (usually 3-5 years). This reflects a less conservative accounting policy which defers some items of costs as intangible assets, which alternatively could have been treated as expenses during the year of cash outflows.

(4) Financial Structure as reflected in the common size balance sheets shows relatively low figures for long-term liabilities (average of 12 per cent of total assets), and rely more on equity financing than debt financing. Of the average of 42 per cent total liabilities for all institutions, short-term financing plays a more significant role in debt financing than long-term borrowing. This indicates the need for placing more emphasis on monitoring liquidity rather than on solvency in credit analysis. (A noticeable exception is the Institution # C, the balance sheet of which exhibits lower degrees of both liquidity and solvency). The trend in liquidity and solvency for all institutions reflects an improving trend over time.

(5) Due to the existence of financial leverage as a result of debt, financing return on equity is significantly higher than return on total assets. This should be interpreted with caution, as private institutions tend to have higher credit risk in the short-term due to reliance on short-term credit more than long-term, which may not be typical for institutions in the introductory stage of development.

(6) Through decomposing return on total assets into its two main components: Return on Assets = Total Asset Turnover x Profit Margin, it may be noted that private institutions rely more on profit margin in achieving profitability due to the relatively low asset turnover (from combined data, average annual return on total assets of 13.3 per cent was achieved through an asset turnover of 1.07 and a profit margin of 13.2 per cent). As institutions will increase their investment base in plant assets when moving to permanent

sites and introduce more engineering and science programmes which require adding more facilities, this may affect the structure of assets and debts, and profitability of these institutions, and need to be looked at from a strategic point of view.

(7) Capital adequacy and growth in equity as a result of earnings retention seems to need a careful analysis. With the exception of the providers: numbered C and E , equity coverage of total expenses exhibits a normal range for the activity level of institutions. However, the trend of negative growth in equity requires a red flag. Investigation of this important issue points to the need for considering dividend policy (or to be explicit fund transfer to parent companies), and increasing owners investment to support a higher adequacy level of equity finance in order to achieve better sustainability and financial stability of private institutions over the long-term.

X. Conclusions and comments

A brief account of funding strategies and financial analysis of private higher institutions in Kuwait has been presented. Generally speaking, the strategy and economic analysis adopted by the founders have proven valid and worthwhile *vis-à-vis* the investment that was allocated. In many cases the turnover of students and enrolment as measured by gross revenue, was better than expected. This should only be taken into account with caution since the leading institutions have not yet been challenged by sufficient local competition, which is expected in the near future.

- Accounting analysis shows that disclosure is still in an evolutionary phase with improving transparency as governance activity is enforced.
- Financial analysis shows that while return on investment improves with time, most institutions show a shortage of liquidity.

This is probably a deliberate strategy from headquarters to not supply more funds than necessary, as financial decisions are still controlled by the parent companies. The governance actions by the Private Universities Council (PUC) are still evolving, as mentioned in *Appendix I*.

The PUC should be adamant and insist on a higher sense of security on the part of the founders which should be obliged to provide more liquidity in the institutions' accounts.

The study also showed considerable discrepancy in the ownership capital than what was actually paid out.. This probably reflects lack of financial experience on the side of the regulatory agency in the early licensing stage.

*   *   *

Appendix I

Accountability and governance rules for private higher education institutions in Kuwait stipulated by the Ministry of Higher Education, Private Universities Council (PUC), Kuwait

I. Ownership

Restrictions on changes in ownership during the first five years since licensing:

- Founders must pay in full their capital shares, in an account controlled by the institution's Board of Trustees, in accordance with the financial plan approved, and during the period determined, by the PUC.

- Founders' representation on the institution's Board of Trustees is restricted to no more than half of all members of the board, plus one.

- The corporation that owns a private institution is not allowed to be listed on the stock exchange before the period stipulated by the PUC, and that, pending its approval.

II. Management

Paid-in-capital of the institution should be made available and controlled by the Board of Trustees (BT) of the institution.

The institution's Board of Trustees has the upper hand in policies regarding dividend distribution and profit retention, and restrictions in form of reserves.

The institution's Board of Trustees should observe rules and regulations set forth by the PUC in carrying out its responsibilities and managing the institution's funds, in accordance with the Executive bylaws of the Private Universities' Law in Kuwait.

III. Financial reporting

An Annual Financial Report prepared by the institution should be audited by an independent auditor in accordance with International Auditing Standards (IAS). The Audit Report should include the auditor's opinion as to the institution's adherence to the Law of Private Universities in Kuwait and to its Executive by-laws.

The institution should maintain regular financial and accounting records in accordance with generally accepted accounting principles, which permit the preparation of its own financial statement as an entity separate from its owner or from its headquarters.

An Annual Financial Report, externally audited by an independent auditor, should be approved for issue by the institution's Board of Trustees, which determines the necessary rules for distribution of profits and use of surplus from activities; in keeping with its rule of managing the institution's funds

IV. Annual review of financial performance

A four-member Standing Committee has been set up by the Private Universities Council (PUC) to monitor the financial performances of private institutions. The committee membership comprises independent professional and academic experts in accounting and finance.

Each institution is required to submit its audited annual financial report to PUC, together with any data and explanations as requested.

A Report is then prepared by the Standing Committee, for each institution, reviewing its financial performance, and gives opinion as to:

(a) The institution's compliance with accountability and governance rules required by PUC.
(b) The implementation of any conditions imposed by PUC in the course of institutional accreditation granted or resulting from previous annual review.
(c) An assessment of the institution's financial position, financial viability and sustainability in terms of return achieved and expected risk. The Financial Committee's Report is presented and reviewed by the Accreditation Committee of the PUC.

Observations and the result of assessment by the Committee are communicated to the institution, requesting explanation if need be. The Financial Committee studies the institution's reply and reports to the Accreditation Committee, recommending any necessary actions to be taken.

The outcome of the financial review process is periodically reported to the Private Universities Council (PUC).

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