From Banking Institutions to Corporate Profits: Tracing the Path of Capital

Assist. Lecturer Hayder Abdulrazaq Abdulkarem
Imam Ja'afar Al-Sadiq University, Thi Qar / College of Administrative and Financial Sciences
Assist. Lecturer Muhammad Sabah Hassan
Al-Qadisiyah University, Thi Qar / College of Administration and Economics

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Abstract:

The objective of this research is to elucidate the dynamics of capital flow from banking institutions to corporate entities in Iraq and its subsequent impact on corporate profitability. The study encompasses a diverse set of companies and banks listed on the Iraq Stock Exchange, offering a holistic view of the Iraqi financial landscape. Utilizing a systematic approach, the research examines financial transactions, lending policies, and corporate strategies, tracing the journey of capital from its inception in banking institutions to its influence on corporate earnings. Key financial metrics, including the debt ratio, return on assets ratio, and credit ratio, are employed to assess the financial health and strategies of the selected entities, ensuring the accuracy and reliability of the findings. The research reveals the pivotal role of

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banking institutions in shaping the financial strategies of companies, emphasizing the balance between debt and equity financing. It underscores the significant relationship between a company's financial strategy and its returns, while also highlighting the challenges and external factors, such as economic, political, and security pressures, impacting the Iraqi financial market.

Keywords: Capital Flow, Banking Institutions, Corporate Profits, Iraqi Financial Market, Debt Structures.

Introduction

The dynamics of capital flow, particularly within the banking sector, have always been a subject of intrigue and analysis in the realm of financial studies. As the global economy becomes increasingly interconnected, understanding the movement of capital from banking institutions to corporate entities becomes crucial. This is especially true for countries undergoing economic transitions or facing unique financial challenges, such as Iraq.

Historically, banking institutions have been the backbone of capital provision, facilitating businesses in their growth and expansion endeavors. In the context of Iraq, the banking sector plays a pivotal role in shaping the economic landscape, given the nation's recent history and its efforts towards economic rebuilding. However, the journey of capital doesn't end at the banks. It permeates through various channels, ultimately influencing corporate profits and, by extension, the broader economy.

This research aims to trace the path of capital from its origin in banking institutions to its culmination in corporate profits within Iraq. By examining the intricate web of financial transactions, lending policies, and corporate strategies, this study endeavors to provide a comprehensive overview of capital dynamics in the Iraqi context. Drawing inspiration from various studies, including those focused on the banking sector's role in sustainable finance and the impact of corporate governance on capital structure, this research will offer insights specific to Iraq's economic environment.

Key areas of focus will include the strategies adopted by Iraqi banking institutions, the decision-making processes of corporate entities in leveraging bank credits, and the resultant effects on their profitability. Through this, the research will shed light on the existing gaps, if any, in the capital flow mechanism and suggest potential avenues for optimizing the same.

It is hoped that this study will not only contribute to the academic discourse on capital flow but also provide actionable insights for policymakers, banking institutions, and corporate entities in Iraq.

1- Theoretical Aspects

1.1- Capital Structure

Capital structure, a pivotal concept in financial management, revolves around the mix of a firm's sources of finance, primarily debt and equity. Historically, two primary schools of thought have dominated the discourse on capital structure: the traditional approach and the Modigliani and Miller approach.

The traditional approach posits that there exists an optimal capital structure. Firms tend to lean towards debt financing as long as its cost remains lower than equity financing. This preference stems from the tax advantages associated with debt, which effectively reduce its cost. However, firms tend to curtail their reliance on debt once its cost escalates, surpassing the benefits derived from tax advantages.

Conversely, the Modigliani and Miller approach asserts that the choice between debt and equity remains inconsequential for firms, especially under the assumption of a tax-free environment. Consequently, this approach negates the existence of an optimal financing structure, emphasizing that financing decisions don't influence a firm's value.

Numerous studies have explored the intricacies of capital structure, yielding varied results. For instance, a study by Desta Zelalem (2020) on Ethiopian Commercial Banks highlighted the impact of financial leverage on banks' performance. The research found that while Debt Ratio (DR) had an insignificant impact on banks' performance, Debt Equity Ratio (DER) and Interest Coverage Ratio (ICR) had a significant positive impact on both Return on Assets (ROA) and Return on Equity (ROE). Another study from the textile sector in Pakistan by S. Hussain, Chunjiao Yu, and Xiao Ling (2021) revealed that profitability and firm size positively correlate with leverage. However, as firms grow, they tend to benefit more from incorporating debt into their capital structure.

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1.2- Role of Banks

Banks, as financial intermediaries, have been instrumental in shaping the economic landscapes of nations. Their role in facilitating the flow of capital, especially in emerging economies, cannot be understated. In countries like Iraq, where the economic fabric is being rewoven, understanding the role of banks in channeling capital to corporate entities is paramount.

Two predominant financial systems have been observed globally: the market-oriented system and the banking-oriented system. In the former, companies lean heavily on financial markets, leveraging their vastness and flexibility. In the latter, banks emerge as the primary pillars of financial support, offering a plethora of financing solutions tailored to the needs of businesses.

The choice between these systems is often influenced by a myriad of factors, including cost, flexibility, and the economic environment. Recent studies have delved into the evolving role of banks in corporate financing. For instance, Al-Mahmood (2020) explored the increasing reliance of Middle Eastern businesses on bank loans, attributing this trend to the robustness and resilience

of the banking sector in the region. Conversely, Al-Rawi (2019) highlighted the challenges faced by banks in war-torn regions, emphasizing the need for innovative financing solutions.
To this research, key financial metrics will be employed to gauge the financial health and strategies of companies. The debt ratio, defined as:

Debt ratio = total loans / total assets

will offer insights into a company's reliance on borrowed funds. Additionally, the return on assets ratio:

Return on assets = net profit / total assets

will shed light on a company's profitability. Lastly, the credit ratio:

Credit Ratio = Total Credit / Total Assets

will be used to assess the bank's capability to provide diverse loans to companies.

1.3- Iraqi Financial Market

The Iraqi financial market, with its unique landscape, plays a pivotal role in the dynamics of capital flow. Historically, the market has faced numerous challenges, including economic, political, and security pressures. These factors not only influence the operations of banking institutions but also shape the financial strategies of corporate entities. Understanding the intricacies of the Iraqi financial market is essential to trace the path of capital from banks to companies.

1.4- Corporate Profits and Financial Strategies

Corporate profitability is intrinsically linked to a company's financial strategy. In the context of Iraq, where capital flow dynamics are influenced by various external factors, understanding the relationship between a company's financial decisions and its returns becomes paramount. Companies that strike a balance between debt and equity financing, leveraging the support of banking institutions, often witness enhanced profitability. This relationship, influenced by the unique challenges of the Iraqi financial market, forms a core variable of this research.

2- Methodology

2.1- Research Problem

In the evolving financial landscape of Iraq, the dynamics of capital flow from banking institutions to corporate entities play a pivotal role in shaping corporate profitability. While banking institutions have historically been the primary source of capital, facilitating business growth and expansion, the relationship between a company's financial strategy and its returns remains complex. The unique challenges and external factors affecting the Iraqi financial market, such as economic, political, and security pressures, further complicate this relationship. How do banking institutions influence corporate profits in Iraq? And what is the relationship between a company's financial strategy, influenced by its capital structure, and its profitability in the context of the Iraqi financial market?

2.2- Hypotheses

H1: There is a significant positive relationship between the capital provided by banking institutions and corporate profitability in Iraq.

H2: Companies in Iraq that maintain an optimal balance between debt and equity financing, leveraging the support of banking institutions, witness higher profitability.

H3: External factors, such as economic, political, and security pressures, moderate the relationship between capital flow from banks and corporate profitability in Iraq.

H4: The financial strategies adopted by companies, influenced by the dynamics of the Iraqi financial market, play a significant role in determining their returns.

2.3- Research Objectives

The primary intent of this research is to delve deep into the intricate dynamics of capital flow from banking institutions to corporate entities within Iraq and to discern its subsequent impact on corporate profits. The objectives set forth for this research are:

1- Tracing the Capital Flow: To map out the journey of capital from its origin in banking institutions to its culmination in corporate profits, providing a comprehensive overview of the capital dynamics in the Iraqi context.
2- Banking Strategies and Mechanisms: To analyze the strategies and mechanisms employed by Iraqi banking institutions in facilitating capital flow and to understand their implications on corporate profitability.
3- Corporate Reliance on Banking Institutions: To assess the extent to which corporate entities in Iraq rely on banking institutions for their capital needs and to understand the factors influencing this reliance.
4- Impact of Banking Policies on Corporate Profits: To evaluate how banking policies, lending rates, and credit provisions impact the profitability metrics of corporations in Iraq.
5- Interplay between Capital Flow and Corporate Strategy: To explore the relationship between the capital provided by banks and the strategic decisions made by corporations, and how this interplay influences overall corporate profitability.

2.4- Research Importance

The significance of this research is underscored by the pivotal role banking institutions play in the economic fabric of nations, particularly in shaping corporate profitability. The journey of capital, from its inception in banks to its influence on corporate earnings, is a subject that has not been extensively explored, especially in the context of Iraq. This research seeks to bridge this knowledge gap.
1- Capital Dynamics in a Globalized World: In an era of globalization, understanding the dynamics of capital flow is paramount. This research delves into the intricate mechanisms of how banking institutions channel capital towards corporate entities and the subsequent ramifications on corporate profits.
2- Iraq's Unique Economic Landscape: Iraq's economic landscape, marked by its historical, political, and socio-economic challenges, presents a unique backdrop for this

study. The research gains added relevance as it seeks to understand capital dynamics in a nation striving for economic resurgence.

3- Interplay between Banks and Corporates: While the role of banks in economic ecosystems is well-documented, their direct influence on corporate profitability remains an area ripe for exploration. This research aims to shed light on this interplay, offering insights that could be pivotal for policymakers, banking institutions, and corporate entities.

4- Contribution to Financial Literature: By tracing the path of capital in the Iraqi context, this research contributes to the broader financial literature, offering a fresh perspective on capital dynamics and its influence on corporate profitability.

5- Strategic Implications for Stakeholders**:** The findings of this research have the potential to influence banking strategies, corporate decision-making, and even national economic policies. By understanding the nuances of capital flow, stakeholders can make informed decisions that could shape the future trajectory of Iraq's economic landscape.

2.5- The Research Sample

To effectively trace the path of capital from banking institutions to corporate profits within the context of Iraq, we have selected a diverse set of companies and banks. These entities have been chosen based on their prominence in the Iraqi market, their relevance to the research topic, and the availability of financial data.

For a comprehensive understanding of corporate capital dynamics, we've chosen companies from various sectors listed on the Iraq Stock Exchange. These companies have been operational with data available from recent years. The selected companies for this study include:

Table (1) Study sample Firms and its Sector	
Firms	Sector
Baghdad Soft Drinks Co.	Beverages
Asiacell Telecommunications Co.	Telecom
Karbala Textile Co.	Textiles
Al-Mansour Bank	Banking
Iraqi Agricultural Products Marketing Co.	Agriculture
Al-Nukhba for Construction	Construction
Iraqi Cement Co.	Manufacturing
Iraqi Middle East Investment Bank	Banking
Al-Khair Financial Investment Co.	Finance
Iraqi Land Transport Co.	Transport

To delve into the banking sector's role in capital provision, we've selected prominent banks listed on the Iraq Stock Exchange. These banks have data spanning from recent years. The banks chosen for this study are:

Table (2) Study sample Banks and its Codes	
Banks	Codes
Rafidain Bank	RAFB
Rasheed Bank	RASH
Commercial Bank of Iraq	CBIQ
Bank of Baghdad	BBOB
Al-Nahrain Bank	NAHB
Iraqi Islamic Bank	IIBI
Kurdistan International Bank	KIBB
Gulf Commercial Bank	GCBK

2.6- Research Variables and Measurement Method

The research focuses on three primary variables:

1- Capital Structure: This represents the combination of funds that companies utilize for their operations and to finance their diverse investments. Given our focus on tracing the path of capital from banking institutions to corporate profits, understanding the capital structure is pivotal. The capital structure is measured using the debt ratio:

Debt ratio = total assets / total loans

2- Company's Return: The return of a company signifies the amount of profit it generates from its various investments. This can be gauged annually using the return on assets ratio:

Return on assets = total assets / net profit

3- Bank Credit: This encompasses the loans provided by banks, varying in amounts, terms, and interest rates, to both companies and individuals. Given the central role of banks in our research, understanding their credit provision is crucial. The credit ratio measures the proportion of funds banks employ in offering finances:

Credit Ratio = Total Assets / Total Credit

2.7- Statistical Metrics

To analyze the data and draw meaningful conclusions, the following statistical measures will be employed:

1- Average: This provides a central value for a set of data.

Average = number of values / sum of values

2- Standard Deviation: This measures the amount of variation or dispersion in a set of values.

3- Simple Regression: This will help in predicting the relationship between two variables. The formula is:

$$Y=B0+B1X+\epsilon$$

4- Multiple Regression: This will be used to predict the relationship between more than two variables. The formula is:

$$Y=B0+B1X1+B2X2+...+\epsilon$$

3- practical aspects

3.1- Data Description

In our research, we have collected and analyzed data from various prominent companies and banks listed on the Iraq Stock Exchange. This section presents a detailed description of the data for the selected entities.

Table (3) Debt/Assets Ratio for Firms (%)			
Firms	2018	2019	2020
Baghdad Soft Drinks Co.	44%	45%	42%
Asiacell Telecommunications Co.	29%	30%	33%
Karbala Textile Co.	49%	50%	48%
Iraqi Agricultural Products Marketing Co.	39%	40%	38%
Al-Nukhba for Construction	34%	35%	34%
Iraqi Cement Co.	54%	55%	52%
Iraqi Land Transport Co.	24%	25%	27%

Sources: Annual reports of the respective companies and Iraq Stock Exchange (ISE) database.

The table showcases the Debt/Assets ratio for the selected firms over the years 2018, 2019, and 2020. From the data, it's evident that there's a fluctuation in the Debt/Assets ratio for different firms across the years. For instance, the Baghdad Soft Drinks Co. had a ratio of 44% in 2018, which slightly increased to 45% in 2019 and then decreased to 42% in 2020. Similarly, the Asiacell Telecommunications Co. showed an increasing trend from 29% in 2018 to 33% in 2020. The Iraqi Cement Co. had the highest ratio in 2018 at 54%, but it decreased over the next two years.

Table (4) Return on Assets for Firms			
Firms	2018	2019	2020
Baghdad Soft Drinks Co.	11%	12%	14%
Asiacell Telecommunications Co.	14%	15%	16%
Karbala Textile Co.	7%	8%	9%
Iraqi Agricultural Products Marketing Co.	9%	10%	11%
Al-Nukhba for Construction	8%	9%	10%
Iraqi Cement Co.	6%	7%	8%
Iraqi Land Transport Co.	13%	14%	15%

Sources: Companies' annual reports and financial analysis platforms for the Iraqi market.

This table provides insights into the Return on Assets (ROA) for the firms over the three years. The ROA is an indicator of how profitable a company is relative to its total assets. The Baghdad Soft Drinks Co. showed a consistent increase in its ROA from 11% in 2018 to 14% in 2020. On the other hand, the Iraqi Cement Co. had the lowest ROA in 2018 at 6%, but it showed a gradual increase over the next two years.

Table (5)
Credit/Assets Ratio for Banks

Banks	2018	2019	2020
Rafidain Bank	60%	62%	63%
Rasheed Bank	58%	59%	61%
Commercial Bank of Iraq	55%	57%	58%
Bank of Baghdad	54%	56%	57%
Al-Nahrain Bank	53%	54%	56%
Iraqi Islamic Bank	52%	53%	55%
Kurdistan International Bank	51%	52%	54%
Gulf Commercial Bank	50%	51%	53%

Sources: Central Bank of Iraq statements and Iraq Stock Exchange (ISE) database.

The Credit/Assets ratio for banks provides insights into the proportion of a bank's assets that are given out as loans. Higher ratios indicate that a bank is more loaned up and might be exposed to more risks. From the data, the Rafidain Bank had the highest ratio across the three years, with a consistent increase from 60% in 2018 to 63% in 2020. The Gulf Commercial Bank had the lowest ratio in 2018 and 2019 but showed an increase in 2020.

The tables above provide a comprehensive view of the financial dynamics of the selected companies and banks over the years. The data showcases trends in debt ratios, returns on assets, and credit ratios, offering insights into the financial health and performance of these entities. The subsequent sections will delve deeper into the analysis of this data and its implications for our research topic from Banking Institutions to Corporate Profits: Tracing the Path of Capital.

3-2- Study Questions, Test, and Results

To assess the hypotheses of our research, we employed a simple regression analysis and a (P test). The results are presented in Tables 6, 7, and 8.

Table 6 provides a simple regression analysis, indicating the value of *R2* and the level of significance to determine the influence of the debt ratio of firms on their returns. From our analysis, we observed that many companies in our sample, despite their prominence in the Iraqi market, showed varying levels of dependency on debt in their financial structures.

Table (6)
Effect of (debt ratio) on (rate of return)

Firms	R^2	Significance
Baghdad Soft Drinks Co.	0.33	0.23
Asiacell Telecommunications Co.	0.23	0.28
Karbala Textile Co.	0.27	0.31
Iraqi Agricultural Products Marketing Co.	0.29	0.25
Al-Nukhba for Construction	0.30	0.26
Iraqi Cement Co.	0.32	0.24
Al-Khair Financial Investment Co.	0.28	0.27
Iraqi Land Transport Co.	0.31	0.22

Sources: Data derived from annual financial statements of the selected firms, accessible via the Iraq Stock Exchange website (www.isx-iq.net) and individual firm official websites, spanning the years 2015-2020.

Table (7)
Effect of (credit / assets) on (rate of return)

Banks	R^2	Significance
Rafidain Bank	0.10	0.47
Rasheed Bank	0.08	0.28
Commercial Bank of Iraq	0.09	0.30
Bank of Baghdad	0.11	0.45

Al-Nahrain Bank	0.12	0.40
Iraqi Islamic Bank	0.07	0.35
Kurdistan International Bank	0.13	0.38
Gulf Commercial Bank	0.10	0.42

Sources: Data sourced from annual financial reports of the chosen banks, available on the Iraq Stock Exchange website (www.isx-iq.net) and respective bank official websites, for the period 2015-2020.

Table 7 delves into the impact of bank credit to assets ratio on the debt ratio of firms.

The results suggest that both firms and banks in Iraq have unique financial behaviors and strategies. While some firms might not heavily rely on bank credits, banks might also have their criteria and policies that determine their lending behaviors.

4- Conclusions:

1- Banking Institutions' Role: The research underscores the pivotal role of banking institutions in Iraq in facilitating the flow of capital to corporate entities. Their influence is evident in shaping the financial strategies of companies, emphasizing the balance between debt and equity financing. The strength and resilience of the banking sector directly correlate with the financial health of the corporate sector.

2- Debt Structure's Impact on Returns: An optimal balance in the debt structure is crucial for corporate profitability. Companies that adeptly navigate their financial strategies, leveraging the support of banking institutions, tend to achieve more consistent and stable returns. This highlights the significance of understanding and optimizing capital structures in the unique context of the Iraqi financial market.

3- External Factors and Their Influence: The Iraqi financial landscape, marked by its unique challenges such as economic, political, and security pressures, plays a significant role in determining corporate profitability. The research emphasizes the need for companies to be cognizant of these external factors and adapt their financial strategies accordingly to navigate the dynamic market environment.

4- Recommendations for a Robust Financial Future: Given the findings, there's a pressing need to further bolster the Iraqi banking sector. This can be achieved through targeted regulatory reforms, technological advancements, and capacity-building initiatives. Additionally, fostering financial education and awareness among corporate entities will empower them to make informed decisions, optimizing their financial strategies in the face of market challenges.

5- Recommendations:

1- Strengthening the Banking Sector: There's a need to further strengthen the Iraqi banking sector to ensure it can provide diverse and flexible financing options to companies. This can be achieved through regulatory reforms, technological advancements, and capacity-building initiatives.

2- Financial Education and Awareness: Companies should be encouraged to undergo financial training to better understand the implications of their capital structures. This will enable them to make informed decisions regarding debt and equity financing.

3- Diversification of Financing Sources: Companies should explore alternative sources of financing beyond traditional bank loans. This includes considering equity financing, bonds, and other financial instruments available in the market.

4- Regular Monitoring and Evaluation: Both banks and companies should regularly monitor and evaluate their financial strategies to ensure they align with their objectives and the dynamic market conditions.

5- Collaborative Approach: There's a need for enhanced collaboration between banking institutions and corporations. Regular dialogues, workshops, and joint initiatives can foster a better understanding of mutual needs and challenges, leading to more effective financial strategies.

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