

Article

Impact of Market Risk Premium on Share Fair Value

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Abstract: This research investigates how the market risk premium influences the fair value of shares traded on the Iraq Stock Exchange using the CAPM model to estimate the required rate of return. The study incorporates the risk-free rate (RF), market portfolio return (RM), and beta-processed risk premium. It addresses the knowledge gap in understanding the risk premium's impact on fair value calculation, a crucial component of the required rate of return. Employing statistical methods, including correlation coefficient measurement and simple and multiple regression analyses, the study demonstrates a significant one-to-one relationship between the risk premium and shares' intrinsic value. These findings have important implications for investors and financial analysts in accurately assessing share values based on market risk premiums.

Keywords: Market Risk Premium, Fair Value, Shares Fair Value

1. Introduction

The challenges facing the banking sector are great and continuous challenges, which necessitates that banks redouble their efforts, such as choosing the best ways to achieve a balance between returns and risks in order to achieve stability in the banking sector. The second aspect summarizes how to face these challenges and the associated risks and ways to get rid of them because of their impact on the country's economies and the dealers and those interested in the banking sector affected by this impact. From this standpoint, the importance of this research comes as it intensifies efforts to find out what departments must do to face the effects of these challenges, which is beneficial to workers and users of financial statements in the banking sector. It enhances confidence in those lists, which is beneficial to making decisions that serve the banking sector.

2. Materials and Methods

The research was conducted in the Iraq Stock Exchange and using banks belonging to the banking sector and includes (14) banks. The table below includes a number of banks in the banking sector.

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Table 1. Shows the Research Sample.

Bank Name	t
National Bank of Iraq	1
Bank of Baghdad	2
Sumer Bank	3
Iraqi Investment Bank	4
Middle East Bank	5
Assyria	6
National Bank of Iraq	7
Mansour Bank	8
Mosul Bank	9
United Bank	10
Gulf Bank	11
Bank of Babylon	12
Kurdistan Bank	13
Iraqi Islamic Bank	14

In the research, we used two types of mathematical statistical methods used in the field of statistical data analysis:

1. CAPM pricing model to estimate the rate of return required to determine the risk premium:

$$R = r_f + (R_M - r_f)B$$

2. Arithmetic mean (average): The arithmetic mean is one of the most important measures of central tendency and the most used to find a point around which the most frequent occurrences in the sample used are gathered, and this point is the one that divides the values of the sample into two identical parts, and it also means the sum of the values divided by their number and is calculated mathematically as follows:

$$\bar{x} = \frac{\sum x_i}{n}$$

3. Standard deviation: square root of the sum of squares of values from their arithmetic mean

$$S = \sqrt{\frac{\sum (y_i - \bar{y})^2}{n - 1}}$$

4. Variance: i.e. the sum of squares of values from their arithmetic mean:

$$S^2 = \frac{\sum (y_i - \bar{y})^2}{n - 1}$$

5. SPSS: It is an abbreviation for the phrase statistical package for the social sciences, which is one of the statistical applications that run the Windows system, and it is a set of lists that the researcher obtains through the data that has been extracted from the financial reports issued by the Iraq Stock Exchange and then analyzed and is characterized by its great ability to process data.

3. Results

Table (2) shows the return of the market portfolio of companies that trade shares in the financial market, which is the period that falls within the period after 2003, where it did not witness sufficient stability with neglect of the economic sectors completely, which reflected its negative effects on economic activity in general, and therefore the returns of the portfolio varied according to fluctuations in the Iraqi economy and the movement of the financial market, which was affected by multiple factors, including the Corona epidemic, which worked to stop economic activity in all its institutions, as well as stop the movement of Aviation, which also has an influential role on the economic movement, and accordingly, it is noted that the portfolio return fluctuates during the period from 2011 to 2020, and the highest rate was for the year 2011, which amounted to 0.20, but the years that followed this year, the return of the portfolio was negative until the year 2019, where the rate of return was swallowed 0.15 for this year and then returned to be negative returns, which is a result of the political and economic conditions facing the Iraqi economy in general.

Table 2. Market Portfolio Return - 2011-2020.

Sector Name	Sunnah Company Name	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average
sector Banks	Commercial Bank of Iraq	-0.09	0.00	-0.28	-0.28	-0.38	0.17	0.02	-0.04	-0.02	-0.04	-0.09
	Bank of Baghdad	0.94	-0.48	0.14	-0.25	-0.25	-0.22	-0.33	-0.53	0.03	0.37	-0.06
	Sumer Consumption	0.01	0.24	-0.02	0.00	-0.05	-0.05	0.00	0.00	-0.43	-0.22	-0.05
	Iraqi Investment Bank	-0.23	0.06	-0.04	0.03	-0.32	-0.12	-0.30	-0.33	-0.04	-0.15	-0.14
	Middle East Bank	0.75	-0.24	0.10	-0.63	-0.15	-0.16	-0.19	-0.63	-0.23	0.20	-0.12
	Ashur International Bank	0.13	-0.06	-0.20	0.26	-0.54	-0.21	-0.12	-0.23	0.04	0.17	-0.08
	National Bank of Iraq	0.05	-0.01	-0.02	0.10	-0.39	-0.26	0.15	-0.28	0.79	0.51	0.06
	Mansour Investment Bank	-0.08	-0.05	0.42	-0.52	0.04	0.14	-0.20	-0.20	0.06	-0.15	-0.05
	North Bank	0.01	0.26	0.19	-0.49	-0.75	0.54	0.67	-0.45	0.34	-0.18	0.01
	Mosul Bank	0.48	-0.37	0.02	-0.16	-0.66	0.24	-0.43	0.50	0.26	0.19	0.01
	United Investment Bank	0.53	-0.32	-0.36	-0.40	-0.48	-0.16	-0.26	-0.61	-0.22	0.14	-0.21
	Gulf Commercial Bank	0.12	0.08	0.06	-0.22	-0.43	-0.12	-0.13	-0.51	-0.26	0.00	-0.14
	Babylon	-0.07	-0.04	-0.10	-0.44	-0.26	0.14	-0.09	-0.37	-0.42	-0.36	-0.20
	Kurdistan International Bank	0.76	-0.16	0.07	-0.16	-0.24	-0.13	0.02	-0.14	-0.92	0.12	-0.08
	Iraqi Islamic Bank	0.12	0.22	0.05	-0.26	-0.46	0.18	-0.17	-0.20	0.00	-0.05	-0.06
sector Industry	Baghdad Packaging Materials Industry	-0.16	-0.39	-0.35	-0.38	0.14	-0.05	-0.25	-0.06	0.52	0.01	-0.10
	Chemical & Plastic Industries	-0.93	-0.76	-0.13	0.01	-0.37	0.15	-0.08	0.14	1.92	0.13	0.01
	Al Mansour Pharmaceutical Industries	0.02	-0.57	-0.26	-0.07	-0.10	-0.12	0.03	-0.07	0.48	0.51	-0.01
	Baghdad Soft Drinks	0.40	-0.03	1.01	-0.24	0.30	-0.15	0.07	0.34	-0.08	0.26	0.19
	Iraqi Carpets & Furnishings	0.04	-0.08	-0.10	0.02	0.01	0.20	0.57	-0.02	0.11	0.13	0.09
	Canadian Veterinary Vaccine Production	0.42	-0.04	-0.37	-0.49	-0.13	-0.29	-0.04	0.65	0.35	-0.19	-0.01
	Metal & Bicycle Industries	-0.30	-0.31	-0.31	-0.30	0.10	-0.28	0.42	1.47	0.62	-0.09	0.10
	Production of ready-made garments	1.66	0.09	-0.29	0.69	0.61	0.08	-0.11	0.04	-0.08	-0.05	0.26
Sector Tourism	Baghdad Hotel	0.07	-0.59	0.35	-0.06	-0.36	0.44	-0.16	0.01	-0.02	-0.05	-0.04
	Karbala Hotel	-0.18	-0.47	-0.48	0.23	0.00	0.00	-0.33	-0.07	-0.15	-0.08	-0.15
	Babylon Hotel	-0.16	-0.19	0.64	0.78	-0.55	-0.10	0.15	0.19	0.69	0.04	0.15
	National Tourism Investment	-0.16	0.12	0.04	-0.08	-0.51	-0.06	-0.24	0.08	0.30	-0.15	-0.07
	The tourist city in Mosul Dam	-0.12	-0.05	-0.67	-0.43	-0.36	0.74	-0.08	-0.16	-0.02	0.02	-0.11
sector Services	Al Mamoura Real Estate Investments	0.42	0.17	0.09	0.17	-0.21	-0.40	-0.18	-0.02	-0.05	0.74	0.07
	Elite General Contracting	-0.17	-0.42	-0.46	-0.22	-0.01	-0.41	-0.12	-0.11	0.31	-0.05	-0.17
	Baghdad Iraq Public Transport	2.06	-0.45	0.98	-0.67	-0.46	-0.14	0.15	0.07	0.14	0.03	0.17
sector Insurance	Al-Ameen Insurance	-0.10	-0.14	0.91	-0.29	-0.46	-0.12	-0.31	-0.36	0.80	0.06	0.00
	Gulf Insurance	-0.49	0.24	0.78	-0.58	-0.48	0.33	0.10	0.09	0.17	0.06	0.02
sector Agriculture	Middle East Fish Production	0.28	-0.37	-0.22	-0.38	-0.10	0.09	0.06	0.14	-0.04	0.09	-0.05
	Iraqi Seed Production	0.68	0.01	0.70	-0.07	-0.15	0.07	-0.33	0.10	0.29	0.27	0.16
	Iraqi Meat Production & Marketing	0.16	0.13	-0.08	-0.06	-0.41	-0.21	1.16	-0.37	-0.05	-0.03	0.02
	Iraqi Agricultural Products	0.40	0.50	0.36	-0.15	-0.30	-0.08	0.06	0.15	0.37	0.05	0.14
Rm		0.20	-0.12	0.06	-0.16	-0.25	-0.01	-0.02	-0.05	0.15	0.06	-0.01

Table (3) shows the rate of return required for the sample companies of Iraqi banks, which is a low rate during the research period for all banks, and this is not considered abnormal if it is known that this period extending from 2003 - until the present time Iraq has not witnessed political and economic stability and suffered from the loss of security stability, and this was reflected in the paralysis of economic starch in Iraq in general, so the required rate of return ranged between 0.046 as the highest rate and 0.043. Three banks were participating at a rate of 0.046, namely the Bank of Baghdad, the Middle East Bank and the Bank of Mosul, while the banks whose returns were at the level of 0.043, as the difference is simple, as the limits of the rate were at a similar level for all banks, as shown in Table (3). It is worth noting the levels of the rate of return for the sample group consistent with the level of the Beta coefficient, which was also at a low level, where the highest beta coefficient was 0.075 for the Kurd Stan Bank and the lowest beta is 0.017 for the Bank of Baghdad.

Table 3. Required Rate of Return

Year Bank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	AV	B
Commercial Bank of Iraq	0.065	0.051	0.058	0.042	0.035	0.045	0.035	0.034	0.041	0.037	0.044	0.045
Bank of Baghdad	0.061	0.056	0.058	0.048	0.044	0.047	0.036	0.036	0.038	0.037	0.046	0.017
Sumer Consumption	0.067	0.048	0.058	0.039	0.031	0.044	0.034	0.032	0.043	0.038	0.043	0.061
Iraqi Investment Bank	0.066	0.049	0.058	0.041	0.033	0.045	0.034	0.033	0.042	0.037	0.044	0.052
Middle East Bank	0.063	0.054	0.058	0.046	0.041	0.046	0.036	0.035	0.039	0.037	0.046	0.027
Assyria	0.064	0.053	0.058	0.044	0.039	0.046	0.035	0.035	0.040	0.037	0.045	0.034
National Bank of Iraq	0.063	0.054	0.058	0.046	0.040	0.046	0.036	0.035	0.039	0.037	0.045	0.028
Mansour Bank	0.065	0.051	0.058	0.043	0.036	0.045	0.035	0.034	0.041	0.037	0.045	0.042
Mosul Bank	0.062	0.055	0.058	0.047	0.042	0.047	0.036	0.036	0.039	0.037	0.046	0.022
United Bank	0.064	0.052	0.058	0.044	0.038	0.046	0.035	0.035	0.040	0.037	0.045	0.036
Gulf Bank	0.066	0.050	0.058	0.041	0.034	0.045	0.035	0.033	0.042	0.037	0.044	0.050
Babylon	0.063	0.053	0.058	0.045	0.040	0.046	0.036	0.035	0.040	0.037	0.045	0.037
Kurdistan Bank	0.069	0.045	0.058	0.036	0.026	0.044	0.033	0.031	0.045	0.038	0.043	0.075
Iraqi Islamic Bank	0.065	0.051	0.058	0.042	0.036	0.045	0.035	0.034	0.041	0.037	0.044	0.043

The risk premium is an additional return against the risk facing the bank in its investment banking activities, and it is calculated by subtracting the risk-free rate of return from the return of the market portfolio and for its calculation multiplied by the risk coefficient, which is the beta coefficient, and thus it becomes a beta-treated risk premium, and the higher the beta coefficient, the higher the required rate of return that is commensurate with the beta level. The risk premium was low for all banks and negative and therefore affected the required rate of return, which was also low, while if the risk premium was high, the required rate of return would also be high, and as can be seen from Table (4), which shows the levels of risk premium, which was characterized by low and negative, it increases with increasing risk and decreases with decrease, so the premium was low.

Table 4. Risk Premium.

Bank Name	Average	Standard deviation	Contrast	Beta	$R_f + (R_m - R_f) \times \text{Beta}$ Required rate of return	Risk Premium
National Bank of Iraq	0.0443	0.010050373	0.00010101	99.49879346	-5.919927608	-5.969927608
Bank of Baghdad	0.0461	0.009071384	8,229E-05	110.2367672	-6.564206035	-6.614206035
Sumer Consumption	0.0434	0.011010904	0.00012124	90.81906703	-5.399144022	-5.449144022
Iraqi Investment Bank	0.0438	0.010533755	0.00011096	94.93290614	-5.645974369	-5.695974369
Middle East Bank	0.0455	0.009330059	8,705E-05	107.1804589	-6.380827536	-6.430827536
Assyria	0.0451	0.009596353	9.209E-05	104.206249	-6.202374942	-6.252374942
National Bank of Iraq	0.0454	0.009382963	8,804E-05	106.5761391	-6.344568345	-6.394568345
Mansour Bank	0.0445	0.009942334	9,885E-05	100.5800074	-5.984800443	-6.034800443
Mosul Bank	0.0459	0.009104395	8,289E-05	109.8370677	-6.540224063	-6.590224063
United Bank	0.0449	0.009585927	9.189E-05	104.3195907	-6.209175439	-6.259175439
Gulf Bank	0.0441	0.010396634	0.00010809	96.18497614	-5.721098568	-5.771098568
Babylon	0.0453	0.009230926	8,521E-05	108.3314902	-6.449889413	-6.499889413
Kurdistan Bank	0.0425	0.012306502	0.00015145	81.25785636	-4.825471382	-4.875471382
Iraqi Islamic Bank	0.0444	0.009961928	9,924E-05	100.3821798	-5.972930789	-6.022930789

The share of the dividend divider was significantly low, which is normal due to political and economic instability and accordingly social, all of which are clearly and significantly influential factors on the course of public life, including the most important economic activity, which was negatively affected by the activity of business establishments in general and led to the flight of Ras abroad. Therefore, the activity was affected and contracted, and accordingly, revenues and profits were low, which is reflected negatively on the dividend divider and thus on the share share. From the dividend divider, as shown in Table (5), where the highest average dividend during the period was 1.0581 dinars, where the National Bank of Iraq had the lowest average was 0.0149 dinars, where it was for the Iraqi Islamic Bank, which indicates the low level of returns for investments surrounded by security and economic instability, and therefore results at this level reflect their negative effects on the fair value of shares, and as shown in Table (5) Table of share of dividend divider. It shows the low dividends due to the low return resulting from the decline in banking activity due to the political and economic conditions that Iraq has gone through over twenty years.

Table 5. Share of Dividend

Year Bank	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	AV
Commercial Bank of Iraq BCOI	0.7497	0.3484	0.3221	0.0117	0.2184	0.4543	0.8866	0.3535	0.5762	0.3237	0750
Bank of Baghdad BBOB	0.0644	0.0477	0.4396	0.0844	0.8651	0.2240	0.4967	0.0023	0.3077	0.0644	0.0477
Iraqi Islamic Bank BIIB	0.6371	0.0149	0.1450	0.0530	0.0092	0.0158	0.1924	0.8083	0.2673	0.6371	0.0149
Middle East Bank BIME	0.1899	0.0328	0.0073	0.0400	0.0015	0.0104	0.5383	0.7266	0.2055	0.1899	0.0328
Iraqi Investment Bank (BIBI)	0.2657	0.1002	0.2605	0.1719	0.2283	0.0966	0.0241	0.0284	0.0471	0.2657	0.1002
National Bank of Iraq BNOI	0.5290	1.0581	0.2809	0.7309	0.0499	0.0983	0.1481	0.1470	0.7450	0.5290	1.0581
Credit Bank of Iraq BROI	0.0856	0.6338	0.5390	0.0650	1.3434	0.0024	0.9027	0.1009	0.0122	0.2329	0.0856
Al Mansour Investment Bank	0.3536	0.3311	0.0250	0.5897	0.0021	0.7837	0.6220	0.0101	0.9944	0.3536	0.3311
Sumer Commercial Bank BSUC	0.2442	0.9696	0.0587	0.5698	0.0011	0.0310	0.0199	0.1212	0.1084	0.2442	0.9696
Babylon BBAY	0.2416	0.2997	0.1263	0.3604	0.7333	0.6895	0.0364	0.0713	0.6482	0.2416	0.2997
Assyria	0.4388	0.5595	0.5274	0.5831	0.8954	0.2043	0.6163	0.5952	0.6067	0.5727	0.4388
Mosul Bank	0.0194	0.0943	0.0553	0.0876	0.0933	0.9825	0.4378	0.2754	0.2960	0.3042	0.0194
United Bank	0.1391	0.0794	0.1924	0.2841	0.6320	0.2471	0.6038	0.3198	0.4943	0.7430	0.1391
Gulf Bank	0.4832	0.6322	0.7931	0.4925	0.6628	0.6582	0.0992	0.6480	0.3971	0.7327	0.4832
Kurdistan Bank	0.0926	0.0339	0.1851	0.4752	0.3031	0.3768	0.4890	0.2361	0.4972	0.2974	0.0926

Table (6) shows the fair value of the shares of the sample banks during the period from 2011– 2020 For the same reasons that were diagnosed that faced Iraqi business establishments for the period after 2003, this value affected that this value was so low that the average period was for some banks less than the nominal value of the share, which is one dinar, which seems not logical that the fair value is lower than the nominal value, but when observing the variables that were adopted in the calculation of fair value, they also appeared consistent with the low levels of the variables adopted in the value calculation, As the loss of security and political stability, and consequently the loss of economic stability and the occupation of some provinces by terrorists, this generates the impression that the Iraqi environment is an environment that repels investment, and therefore investment banking activity was limited to narrow and ineffective activities.

In return, as can be seen from the table, the highest average fair value was for the Bank of Kurdistan, where the average was 1.811 dinars, followed by the Bank of Baghdad, where it reached 1.444 dinars, and these figures in economic measures are low, but compared to the selected sample group were the best, as the lowest average was 0.698 dinars, where it was the share of the Bank of Babylon, and this average is less than the nominal value of the share, and this indicates that economic activity was affected by the conditions that faced Iraq during the period and the sector. Banker specifically.

Table 6. Fair Value of Shares

Sunnah Bank Name	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average
Commercial Bank of Iraq	1.412	1.757	1.204	1.484	0.835	0.668	0.485	0.766	0.777	1.147	1.0535
Bank of Baghdad	3.569	1.707	2.417	1.693	1.949	0.95	1.013	0.326	0.351	0.466	1.4441
Sumer Consumption	0.87	1.089	0.964	0.991	0.923	1.408	0.927	1.812	0.723	0.708	1.0415
Iraqi Investment Bank	0.935	0.99	0.94	1.053	0.879	0.739	0.658	0.368	0.514	0.317	0.7393
Middle East Bank	2	2.075	2.021	0.584	0.491	0.449	0.345	0.157	0.279	0.148	0.8549
Assyria	1.46	1.45	1.262	1.481	0.610	1.18	0.85	0.73	0.76	0.69	1.0473
National Bank of Iraq	1.5	0.936	0.915	0.954	0.577	1.091	0.725	1.351	1.096	1.19	1.0335
Mansour Bank	2.145	1.18	2.27	1.557	0.842	1.512	0.729	1.162	1.118	0.782	1.3297
Mosul Bank	1.55	1.08	1.083	1.11	1.183	0.624	0.393	0.208	0.245	0.144	0.762
United Bank	1.68	1.44	1.57	1.46	0.73	0.81	0.60	0.31	0.14	0.21	0.895
Gulf Bank	1.635	1.416	1.699	0.960	1.130	1.065	0.853	0.952	0.741	0.601	1.1052
Babylon	0.89	0.97	0.945	0.494	0.625	1.017	0.955	0.219	0.174	0.693	0.6982
Kurdistan Bank	2.617	2.485	2.350	2.306	1.774	1.497	1.699	1.246	1.076	1.062	1.8112
Iraqi Islamic Bank	0.994	1.776	1.233	1.051	0.543	0.583	0.498	0.573	1.161	0.624	0.9036

The approved research hypothesis is that there is a significant correlation and effect between the risk premium and the fair value of the shares of the sample group of banks, as is clear from the data of the table

(7) and the level of correlation (0.517) and this expresses the existence of a positive and medium correlation between the two variables and the table also showed that the level of impact of the risk premium in the second variable is the fair value at the level of (0.048) and statistically significant at the level of (0.05), and the value of (F) calculated is (4.371) which is higher than the tabular (3.964) Therefore, do not reject the research hypothesis that there is a correlation and influence between the two variables.

Table 7. Matrix of Correlation and Influence Relationships for Research Variables

Morale level	Beta	F	R2	Calculated T value	R	Risk Premium
0.048	0.517	4.371	0.267	2.091	0.517	Fair Value

Source: Prepared by the researcher based on the program (Spss, vev.26)

4. Discussion

The results show low levels of returns for the sample banks during the research period due to unstable conditions of all kinds, which affected the investment path. It is also evident that the required rate of return and the level of risk are low due to the paralysis of the Iraqi economy in all its sectors. The results also show that there is a positive and significant relationship between the two variables, but it is a medium relationship, which is significant at the level of (0.02). In addition, there is a decrease in the fair value of the sample bank shares due to the low levels of return for the same reasons. Therefore, it is necessary, in light of the unstable conditions affecting the course of economic activity, and the reflection of this effect on the nature of the business of business establishments, including the sample banks, and they must search for investment opportunities that will benefit them economically. Interest rates on short-term loans should also be reduced to encourage short-term investments.

5. Conclusion

This research investigates how the market risk premium influences the fair value of shares traded on the Iraq Stock Exchange using the CAPM model to estimate the required rate of return. The study incorporates the risk-free rate (RF), market portfolio return (RM), and beta-processed risk premium. It addresses the knowledge gap in understanding the risk premium's impact on fair value calculation, a crucial component of the required rate of return. Employing statistical methods, including correlation coefficient measurement and simple and multiple regression analyses, the study demonstrates a significant one-to-one relationship between the risk premium and shares' intrinsic value. The findings show low levels of returns for the sample banks during the research period due to unstable conditions, affecting the investment path. The required rate of return and the level of risk are low due to the paralysis of the Iraqi economy in all its sectors. The results also indicate a positive and significant, though medium, relationship between the risk premium and fair value, significant at the 0.02 level. Additionally, there is a decrease in the fair value of the sample bank shares due to the low levels of return for the same reasons. It is essential, given the unstable conditions affecting economic activity and their impact on business establishments, including the sample banks, to search for investment opportunities that will benefit them economically. Reducing interest rates on short-term loans could encourage short-term investments. Further research should explore alternative models to CAPM in volatile economies and investigate sector-specific impacts of market risk premiums on fair value.

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