Law, culture, financial market development and
global investment strategy:
Lessons from the Middle East and North Africa

A thesis presented

by

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to

the Department of Finance

in partial fulfilment of the requirements for the degree of

Doctor of Philosophy
(with a coursework component)
in the subject of

Finance

Bond University
Queensland, Australia
May, 2016
This thesis consists of two essays that address the intersection of law, culture and finance. The ‘Law and Finance’ theory is augmented to account specifically for the historical complexity in legal origin and the variability of legal structure that exist in the Middle East and North Africa (MENA). The underlying theme throughout this thesis focuses on the role that law and culture play in shaping financial markets and global investment opportunities. How the legal environment and the prevailing Islamic culture shape financial market development in the MENA region is the subject of Essay 1. This is followed by an analysis of the determinants of US mutual fund investment in MENA firms in Essay 2.

The first essay examines how the legal rules protecting creditors and shareholders, law enforcement, judicial efficiency, legal duality and the prevailing Islamic culture influence the development of credit and stock markets in 21 MENA countries for the period 2007-2012. The results from OLS and bootstrap regressions show that the availability of more credit information and the quality of the collateral and bankruptcy laws are critical in the development of credit markets, whereas, disclosing self-dealing transactions and protecting minority shareholders advance stock market development. However, stock market development is deterred when shareholder protection mechanisms allow aggrieved shareholders to sue for self-dealing transactions or access to information to examine self-dealing. Not only does the quality of the legal rules matter, but also the extent of its enforcement is a strong determinant of financial market development. Additionally, the judicial efficiency in resolving commercial disputes marginally benefits financial markets. The duality in MENA legal systems creates investment uncertainty that dampens financial market development. Countries with less Islamic endorsement in their institutions operate more advanced financial markets.

The second essay investigates whether US mutual fund investments in MENA firms are influenced by the quality of the legal environment and financial market development as predicted by the ‘Law and Finance’ theory. Using the investments of 438 US mutual funds in 7,986 locally listed firms in 11 MENA countries for the period 2008-2012, the logistic and tobit regression results reveal that reducing information asymmetry is key to attracting US mutual fund investment. Well-developed stock markets and the existence of shareholder protection mechanisms related to information disclosure quality are both positively associated with US mutual fund investment. However, remedial shareholder protection mechanisms in the form of ease of litigation and the ability to hold directors liable for misconduct are not associated with US mutual fund investment. Empirical evidence also suggests that MENA firms may overcome the
legal environmental shortcomings by signalling quality to foreign investors through adopting IFRS or via appointing a ‘big-four’ auditor.

Overall, these two essays contribute to the ‘Law and Finance’ literature. Countries with complex legal systems require a more exacting legal characterisation beyond the historical narrative or legal origin. Further, only ‘pre-emptive’ shareholder protection mechanisms related to the disclosure of self-dealing attract foreign capital and promote stock market development. Finally, culture should not be overlooked as a determinant of financial market development as culture reflects attitudes and norms not easily detectable and quantifiable in the law.
DECLARATION

This thesis is submitted to Bond University in fulfilment of the requirements of the degree of Doctor of Philosophy. This thesis represents my own original work towards this research degree and contains no material which has been previously submitted for a degree or diploma at this University or any other institution, except where due acknowledgement is made.

Signature: ____________________________________________________________

Bayan M. Arqawi
ACKNOWLEDGMENTS

I am profoundly thankful to my supervisors Li-Anne Woo and Laurie Prather for their rich comments, lengthy discussions, time and patience throughout the study. They both engaged in an active mind and a willing heart to help me succeed and accomplish this thesis. I appreciate them both not only as helpful supervisors with sharp intellect, but also as esteemed professionals with great integrity.

I also thank the administrative supervisor, Mark Spence, for managing the thesis progress smoothly. I extend my gratitude to Gulasekaran Rajaguru and Tom Smith for their helpful workshops and econometric advice. The financial support from the Australian Government is gratefully acknowledged.

My friends, David Perry and Will Bertin are sincerely thanked for being consistently supportive and inspiring.

Finally, and most importantly, I am indebted to Ghassan Jaser who enlightens the dark moments and makes all things possible.
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