

**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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## ABSTRACT

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:

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Bayan M. Arqawi

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# TABLE OF CONTENTS

<b>ABSTRACT .....</b>	<b>i</b>
<b>CHAPTER 1 Introduction.....</b>	<b>1</b>
1.1. MENA background .....	3
<b>CHAPTER 2 Legal environment, culture and financial market development: Evidence from the MENA .....</b>	<b>10</b>
2.1. Introduction .....	10
2.1.1. Research questions.....	12
2.1.2. Contributions and objectives .....	12
2.1.3. Essay structure .....	13
2.2. Literature review.....	15
2.2.1. ‘Law and Finance’: commonalities, controversies and criticism .....	15
2.2.2. Culture .....	24
2.3. Development of MENA legal systems .....	28
2.4. Research design .....	32
2.4.1. Sample .....	32
2.4.2. Index construction .....	32
2.4.2.1. Anti-director rights index .....	32
2.4.2.2. Sharia constitutional role.....	37
2.4.2.3. Islamic culture .....	43
2.4.3. Model.....	46
2.4.4. Variables .....	47
2.4.4.1. Financial market development.....	48
2.4.4.2. Legal environment.....	49
2.4.4.2.1. Investor protection .....	49
2.4.4.2.2. Law enforcement.....	50
2.4.4.2.3. Judicial efficiency .....	50
2.4.4.2.4. Dual legal system.....	51
2.4.4.3. Culture .....	51
2.4.4.4. Control variables .....	51
2.4.5. Estimation.....	65
2.5. Empirical analysis .....	71
2.5.1. Univariate and bivariate analysis.....	71
2.5.2. Multivariate analysis.....	86

2.5.3. Robustness analysis .....	109
2.6. Conclusion .....	111
2.6.1. Summary and implications .....	111
2.6.2. Limitations .....	114
2.6.3. Further research .....	115
<b>CHAPTER 3 Determinants of US mutual fund investment in MENA .....</b>	<b>116</b>
3.1. Introduction .....	116
3.1.1. Contributions and objectives .....	118
3.1.2. Essay structure .....	120
3.2. Literature review.....	121
3.2.1. Legal environment .....	123
3.2.2. Stock market development .....	126
3.2.3. Firm’s discretionary policies .....	127
3.3. Research design .....	131
3.3.1. Sample .....	131
3.3.2. Model.....	133
3.3.3. Variables .....	135
3.3.4. Estimation .....	139
3.4. Empirical analysis .....	142
3.4.1. Descriptive statistics .....	142
3.4.1.1. US mutual fund investment in MENA .....	142
3.4.1.2. Univariate analysis .....	151
3.4.1.3. Bivariate analysis.....	156
3.4.2. Regression analysis.....	163
3.5. Conclusion.....	179
3.5.1. Summary and implications .....	179
3.5.2. Limitations.....	180
3.5.3. Further research .....	181
<b>CHAPTER 4 Final remarks .....</b>	<b>183</b>
<b>APPENDICES .....</b>	<b>187</b>
<b>BIBLIOGRAPHY .....</b>	<b>280</b>
<b>LEGISLATIONS.....</b>	<b>292</b>

## LIST OF TABLES

Table 2.1 Former coloniser and year of independence for MENA countries .....	30
Table 2.2 Anti-director rights index for MENA countries .....	34
Table 2.3 Laws and regulations relevant for shareholder protection .....	35
Table 2.4 Constitutional role of Sharia .....	40
Table 2.5 Islamic institutionalisation index .....	45
Table 2.6 List of variables for essay 1 .....	52
Table 2.7 A summary of the model for financial market development .....	64
Table 2.8 Descriptive statistics for essay 1 .....	76
Table 2.9 Pearson correlation matrix .....	78
Table 2.10 Frequency table for investor protection by legal origin .....	82
Table 2.11 Frequency table for Islamic culture and Sharia index by legal origin .....	83
Table 2.12 Testing the equality of mean and median for legal origin.....	85
Table 2.13 OLS results for financial market development and legal origin .....	87
Table 2.14 OLS results for credit market development and creditor protection.....	92
Table 2.15 OLS results for stock market development and shareholder protection .....	93
Table 2.16 OLS results for financial market development and law enforcement.....	97
Table 2.17 OLS results for credit market development and judicial efficiency.....	98
Table 2.18 OLS results for stock market development and judicial efficiency .....	99
Table 2.19 OLS results for credit market development and Islamic culture.....	102
Table 2.20 OLS results for stock market development and Islamic culture .....	103
Table 2.21 OLS results for financial market development and legal duality.....	106
Table 2.22 OLS results for influences on credit market development.....	107
Table 2.23 OLS results for influences on stock market development.....	107
Table 2.24 Economic significance for influences on financial market development .....	108
Table 3.1 Morningstar <sup>®</sup> Principia <sup>®</sup> coverage .....	119
Table 3.2 List of variables for essay 2.....	138



Table 3.3: Prospectus objective for the US mutual funds investing in MENA.....	143
Table 3.4: Equity style box for the US mutual funds investing in MENA .....	143
Table 3.5 US mutual fund investment in MENA by country (2008-2012).....	145
Table 3.6 US mutual fund investment in MENA by sector (2008-2012) .....	147
Table 3.7 MENA firms and US mutual fund investment (2008-2012).....	150
Table 3.8 Descriptive statistics for essay 2 .....	152
Table 3.9 Descriptive statistics by country .....	155
Table 3.10 Pearson correlation matrix .....	157
Table 3.11 Frequency table for investment by shareholder protection .....	158
Table 3.12 Means test for financial market development and shareholder protection.....	161
Table 3.13 Frequency table for investment by discretionary policies.....	162
Table 3.14 Logistic results for investment, legal environment and financial market development .....	167
Table 3.15 Logistic results for investment and the interaction between shareholder protection and financial market development .....	171
Table 3.16 Logistic results for investment and accounting standards selection .....	176
Table 3.17 Logistic results for investment and auditor selection.....	177

## LIST OF FIGURES

Figure 1.1 Thesis essays .....	3
Figure 1.2 Map of the MENA region .....	4
Figure 1.3 MENA capital (2007-2012) .....	6
Figure 2.1 Distribution of legal origin .....	17
Figure 2.2 Map of Ottoman Empire (1299-1922) .....	28
Figure 2.3 Western controlled territories in the 20th century .....	29
Figure 2.4 Financial market development framework .....	47
Figure 2.5 Bootstrap replications selection .....	69
Figure 2.6 Comparative creditor protection: (average 2006-2011).....	72
Figure 2.7 Comparative shareholder protection: (average 2006-2011) .....	73
Figure 2.8 Comparative Islamic culture .....	75
Figure 2.9 Comparative Sharia index.....	75
Figure 3.1 Construction of the sample .....	132
Figure 3.2 MENA universe of investable firms .....	132
Figure 3.3 US mutual fund investment in MENA by country (2008-2012) .....	146
Figure 3.4 Number of US mutual funds in MENA by country (2008-2012).....	146
Figure 3.5 US mutual fund investment in MENA by sector (2008-2012).....	148
Figure 3.6 Number of US mutual funds in MENA by sector (2008-2012).....	148
Figure 3.7 Risk and return profile for MENA firms .....	149
Figure 3.8 Predictive margins for shareholder protection indices.....	168
Figure 3.9 Predictive margins for shareholder protection indices by legal origin .....	169

## APPENDICES

Appendix 1 Shareholder protection in MENA countries .....	188
Appendix 2 Constitutional role of Sharia.....	233
Appendix 3 List of variables used in the ‘Law and Finance’ literature .....	239
Appendix 4 Descriptive statistics by country .....	250
Appendix 5 Bootstrap results .....	264
Appendix 6 Tobit results .....	274