Chapter 10
The Determinants of Stock Market Development and Liquidity in Capital Markets

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ABSTRACT

"At the early stages of its establishment the stock market is a complement rather than substitute for the banking sector. Developing the banking sector can promote stock market development as demonstrated by the experiences of many East Asian countries. However, when stock markets are sufficiently developed they tend to compete with the banking sector as shown by findings." How does commercial banking impact investment activities in capital markets – and particularly developed capital markets? Is it true then that in certain economies, the banking sector serves as a complementary component of the financial system – up till a stage where it begins to compete with the securities sector? As well as investigating these observations, this chapter is aimed at investigating the validity of Efficient Markets Hypothesis and Efficient Capital Markets Hypothesis in emerging economies – as contrasted with advanced market economies. In so doing, it aims to contribute to the extant literature on stock market liquidity and liquidity in capital markets.

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INTRODUCTION

How does commercial banking impact investment activities in capital markets – and particularly developed capital markets? Is it true then that in certain economies, the banking sector serves as a complementary component of the financial system – up till a stage where it begins to compete with the securities sector?

At the early stages of its establishment the stock market is a complement rather than substitute for the banking sector. Developing the banking sector can promote stock market development as demonstrated by the experiences of many East Asian countries. Support services from the banking system contribute significantly to the development of the stock market. However, when stock markets are sufficiently developed they tend to compete with the banking sector as shown by our findings. (Yartey, 2008)

As well as investigating these observations, the chapter will amongst other objectives, aim to contribute to the extant literature on whether capital markets in emerging markets economies, in particular, fully reflect information - hence demonstrating and highlighting the validity of the Efficient Markets Hypothesis (as well as the Efficient Capital Markets Hypothesis.

Other objectives of the chapter are as follows:

1. To investigate the extent to which accounting information can be relied upon based on given market values and whether a relationship or pattern can be established in certain jurisdictions based on given operating variables which function in such economies.
2. To demonstrate and highlight the validity of the Efficient Markets Hypothesis (as well as the Efficient Capital Markets Hypothesis)
3. To demonstrate how accounting information can serve as a useful and vital indicator which will enable investors to interpret financial information in such a way which mitigates information asymmetries between management and investors
4. To highlight those areas and factors which influence the quality of accounting information - and which must be addressed by markets if the audit is to achieve its intended aims and functions
5. To highlight whether accounting reforms undertaken in investigated jurisdictions actually achieved their desired goals of improving the quality of accounting information and if such reforms were not successful, to propose measures which could address the current issues being faced by such jurisdictions.