The development of stock market has always been the topic of a lot of studies all over the world. These studies have showed empirically that the stock market plays an important role in the process of economic growth and development. They have also pointed out the critical prerequisites to the proper functioning of a stock market. They have examined the factors that impede as well as facilitate the development and/or creation of less developed economies’ stock markets. An attempt is made here to review the works carried out by researchers in order to indentify the research gap. The review presented here is classified under six subheadings, as follows:

- Studies on financial development and economic growth,
- Studies on stock market development and economic growth,
- Studies on the determinants (prerequisites) of stock market development,
- Hurdles to development of small stock market, and
- Past studies on establishing a stock exchange in Yemen.

3.1 Studies on Financial Development and Economic Growth

The relationship between the financial development and the economic growth has been an important issue of debate. Different aspects of this relationship have been analyzed extensively in both theoretical and empirical studies. Much of the literature on economic growth deals with this causal relationship between financial development and economic growth along three lines: first, the financial deepening stimulates economic growth. Financial markets are able to provide savers with a relatively higher yield, and thus stimulate savings. For example, King and Levine (1993) researched cross-country data of 80 countries over the period 1960-1989. They found that various measures of the level of financial development are strongly associated with the real per capita GDP growth, the rate of physical capital accumulation, and improvements in the efficiency with which the economies employ physical capital. Further, the predetermined component of financial development is robustly correlated with future rates of economic growth, physical capital accumulation, and economic efficiency improvements. Ahmad and Malik (2009) analyzed the role of financial sector development in economic growth and domestic
and foreign capital accumulation by using a panel data set for 35 developing countries over the period 1970-2003. A major finding of the research is that financial sector development affects per capita GDP mainly through its role in efficient resource allocation, rather than its effects on capital accumulation.

Secondly, economic growth promotes the development of the financial sector. In this view, financial development appears as a consequence of the overall economic development. Continual economic expansion requires more financial services and new financial instruments. The financial system adapts itself to the financing needs of the real sector and fits in with its economic development. Therefore, this type of financial development plays a rather passive role in the growth process (Garcia and Liu, 1999).

Thirdly, there is a reciprocal relationship between the financial development and economic growth simultaneously that affect each other. Garcia and Liu (1999) pointed out that economic growth makes the development of financial intermediation system profitable, and the establishment of an efficient financial system permits faster economic growth. By specializing in fund pooling, risk diversification, liquidity management, project evaluation and monitoring, the financial sector increases with its size because economies of scale and learning-by-doing effects are present in financial intermediation activities. As a result, the real sector can exert a positive externality on the financial sector through the rise in the volume of savings.

Liu and Shu (2002) examined the causal relationship between financial development and economic growth in China by employing the Granger causality test within a VARECM framework. They found a reciprocal causality between financial development and growth, suggesting that economic growth and financial development are mutually reinforcing under an open-door policy. Another supported study by Kar and Pentecost (2000) explored the causal link between financial development and economic growth in Turkey. Five alternative proxies for financial development are developed and Granger causality tests applied using the cointegration and vector error correction methodology (VECM). The finding shows that the direction of causality between financial development and economic growth in Turkey is sensitive to the choice of proxy used for financial development. For example, when financial development is measured by the money-to-income ratio, the direction of causality

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runs from financial development to economic growth, but when the bank deposits, private credit and domestic credit ratios are alternatively used as proxy for financial development, growth is found to lead financial development. On balance, however, for Turkey, growth seems to lead financial sector development.

Teame (2005) investigated the causal relationship between the level of financial development and economic growth in 13 Sub-Saharan African countries. The results of the cointegration analysis provide evidence of the existence of a long-run relationship between financial development and economic growth in almost all 12 out of 13 countries. With respect to the direction of long-term causality, the results show that financial development plays a causal role on economic growth, again in eight of the countries. At the same time, evidence of bi-directional causal relationships is found in six countries. The findings imply that African countries can accelerate their economic growth by improving their financial systems.

Financial development and economic growth have positive effects on each other in the process of development. Consequently, most of the authors at present time prefer to describe the relationship as a two-way causation.

3.2 Studies on Stock Market Development and Economic Growth

There are a number of reasons as to why a new stock exchange can increase economic growth. In principle, the creation of stock exchange is expected to accelerate economic growth through providing mobilization of domestic savings and increasing the quantity and the quality of investment. Levine and Zervos (1998) investigated that stock market liquidity and banking development both positively predict growth, capital accumulation, and productivity improvements when entered together in regressions, even after controlling for economic and political factors. The results are consistent with the views that financial markets provide important services for growth, and that stock markets provide different services from banks.

Minier (2003) studied nearly sixty countries that have opened their first national stock exchanges since 1950. The study provides some evidence that, despite the small size of most newly opened exchanges, opening a stock exchange is positively correlated with subsequent growth rates, economic freedom, expected growth rates, and the endogenous determination of the decision to open an exchange.
This study provided more relevant policy implications for countries without a stock market than previous studies, suggesting that opening a stock exchange may increase growth rates. As a result, a growing number of developing countries have recognized the useful role that stock markets can play in enhancing the efficiency of domestic financial systems, which pay special attention to establishing and developing financial stock markets. They emphasize this end as one of the priorities in their economic reform programs. Figure 3.1 shows the potential positive impact of the financial markets (stock exchanges) and intermediaries on economic growth.

The stock exchange is supposed to ensure through the takeover mechanism that past and existing resources are most efficiently utilized. The risk of takeover is expected to provide management with an incentive to maximize the value of the company. The presumption is that if management does not maximize company's value, another agent may take control of the company, replace management and reap the gains. Thus, a free market in corporate control is expected to provide the best guarantee of achieving efficiency in the use of assets, as well as, the ability to make changes in the management of listed companies which is expected to ensure that managerial resources are used efficiently (Yartey and Adjasi, 2007). The stock exchange is also expected to provide individuals with an additional financial instrument that may better meet their risk preferences and liquidity needs. Efficient stock markets enable savings to be allocated to investment projects with higher returns and making savings more attractive (Yartey, 2008).
Figure 3.1
Impact of the Financial Markets on Economic Growth

- Market frictions
- Information costs
- Transaction costs

Financial market and Intermediaries

Financial functions

- Mobilize savings
- Allocate resources
- Exert corporate control
- Facilitate risk management
- Ease trading of goods, services and contracts.

Channels to growth
- Capital accumulation
- Technological innovation

Economic Growth

Stock exchange can also become an important channel to raise external finance. Debt finance becomes less available as a consequence of the debt crisis and the ongoing third world debt crisis motivates developing countries to rely on equity rather than debt (ESCWA, 2003). Study by Singh and Glen (2004) found that large developing-country business corporations rely, to a great extent, on external rather than internal finance and within external finance on equity rather than debt. This result has been used to argue in favor of investing heavily in stock market development in the African countries. The Asian financial crisis in the 1990s gives some evidence that the heavy reliance on banks increases the vulnerability of financial systems. Development of stock market can protect economies from financial shocks. In this regard, capital markets are considered better avenues of mobilizing domestic and international capital (Kibuthu, 2005). Equity capital flows accounted for 80 percent of total external financing to the developing countries during 1999-2003, compared with only 60 percent during 1993–98 (World Bank, 2005).

Yartey (2006) examined the corporate financing patterns in Ghana, in particular, whether listed Ghanaian corporations make considerable use of the stock market to finance their growth. The researcher investigated econometrically the effect of stock market development on the importance of debt relative to external equity in the balance sheets of Ghanaian firms. The results show that the average listed Ghanaian firm finances its growth mainly from short-term debt. The stock market, however, is the most important source of long-term external finance. Stock market development tends to shift the financial structure of Ghanaian firms toward more of equity and less of debt. Overall, the evidence suggests that the stock market is a surprisingly important source of finance for funding corporate growth.

The establishment of stock exchange in developing countries and their opening to foreign security investment houses have been central to the domestic financial liberalization programs of most emerging markets (Ilmolelian, 2005). Stock markets are also very important in recent years as a major channel for foreign capital flows to emerging economies. For example, net equity flows (FDI and portfolio flows) to the developing countries have grown to around 192 billion dollars in 2004, providing an important source of capital for development (World Bank, 2005).
Moreover, stock market liquidity is expected to enable investors to diversify across a variety of assets hence reducing risk. The initial investors may not lose access to their savings for the investment project because they can easily sell their shares in the company (Mala and White, 2006). Capital is not prematurely removed from firms to meet short-term liquidity needs, also it helps in matching the long-term horizon of borrowers with the short-term liquidity preference of investors by allowing those who are hit by a liquidity shock to sell their shares to other investors who do not suffer from a liquidity shock (Nowbutsing, 2009).

Furthermore, stock markets can usefully complement or compete with the banking sector, thereby reducing the cost of capital for borrowers. They also permit a diversification of company ownership, more efficient risk sharing, and a healthier financial structure of corporations by improving their debt/equity ratios. The opportunities which stock markets offer investors for diversifying their portfolios also help lowering the risk premium component in the cost of capital (Ilmolelian, 2005).

Stock market has been considered to be an important channel to raise long-term capital by issuing securities to the public in the form of initial public offerings (IPOs) or additional issue of stocks. For example, Ziorklui (2001) studied the Dar-es-Salaam Stock Exchange (DSE) in Tanzania and found that the inability of the banking sector to provide a long-term credit to the private sector had created the need for the establishment of the DSE in Tanzania to fulfill the role of mobilizing and allocating long-term capital to the private sector for growth and poverty alleviation.

Efficient stock markets may also reduce the costs of information. They may do so through the generation and dissemination of firm-specific information that efficient stock prices reveal. King and Levine (1993) indicated that a new stock exchange can provide aggregating information about firm's prospects, thereby directing capital to investment with returns. In addition, listing on stock markets implies disclosure of information to investors; this will encourage firms to improve accounting standards and make management more transparent. Besides, information on stock prices determined in exchanges and other publicly available information may help investor make better investment decisions and thereby ensure better allocation of funds among corporations and, as a result, a higher rate of economic growth (Yartey and Adjasi, 2007).
Shen and Wei (2007) examined the determinants of IPOs in Taiwan for the period 1989 to 2000. They found strong evidence that IPOs are not motivated by financing need, that larger and profitable firms are more likely to list equity, and that venture capital provides certification to firm credibility. They also provided support for information asymmetry, listing costs, liquidity, owners’ diversification desire, timing, and facilitation of mergers and acquisitions as factors influencing IPO decisions. Moreover, a well-developed stock exchange provides guidelines as a means for the exercise of monetary policy through the issuance and repurchase of government securities in the liquid market. In addition, well-developed and active stock markets could modify the pattern of demand for money, and booming stock markets create liquidity, and hence spur economic growth (Shahbaz et al, 2008).

Finally, researchers add other objectives that stock markets can usefully serve. Government policies promote privatization and debt-equity swaps. Dawit (1999) concluded that privatization and stock market development are closely linked and mutually reinforcing and recommended it as a long-term solution to broaden ownership; it also went to recommend that the method of directed group ownership should be implemented as a medium-term solution concurrently with stock market development for an optimal path to broaden local participation in privatization of public assets. The researcher also pointed out that privatization through stock exchanges can facilitate the public flotation of shares, as well as help narrowing the income gap. The most prominent and successful example in this regard was the privatization of Ashanti Goldfields in Ghana, the largest mining company in Sub-Saharan Africa, outside South Africa. The shares of the company were listed on the Accra Stock Exchange, the London Stock Exchange in 1994, and the New York Stock Exchange in 1996. In 2004, it merged with AngloGold to create the world's second largest gold producer. The successful privatization of Kenya Airways in 1996 was another well-known example of public flotation through the stock exchange.

On the other hand, some critics of the stock market have argued that the establishment of stock market would be important only when the country is in an advanced stage of development. The empirical studies of developing economies by Singh and Hamid (1992) found that while large companies benefited from opening of stock exchange, the host economy as a whole “gained little” because in many cases,
investment in portfolio shares replaced bank savings, with no increase in total savings or investment. Another supporting study in Sub-Saharan African countries by Singh (1999) explained the pros and cons of establishing stock markets in Sub-Saharan African economies at the present stage of their development. The researcher pointed out that the African countries would do better to use their scarce human, material, financial and institutional resources in improving the functioning and prudential regulation of banking systems in these underdeveloped economies than to promote stock markets. Singh concluded that establishment of the stock exchange would be a costly irrelevance for many African economies which they can ill afford; for a number of others, it is likely to do more harm than good, especially those with weak banking systems. Minier (2003) suggested that the relationship between stock market development and economic growth may, in fact, be different in countries with smaller stock markets. In particular, mere opening a national exchange may not be enough to generate positive growth effects: market capitalization may need to reach a certain level before the growth effects are realized. Irving (2005) supported a “gradual approach” to financial development, which focuses on developing commercial banks and medium- and long-term credit institutions, with consideration given to setting up a stock exchange only when a country is at an “advanced stage of industrialization”.

Critics moreover argued that stock market liquidity may hinder corporate governance because a very liquid stock market may encourage investor myopia. A study of the United States stock market suggests that liquidity is costly in terms of hindering corporate governance and internal monitoring. There is a lack of incentives to encourage internal monitoring, leading to a problem in governance, and possibly too much emphasis on external monitoring. Active shareholders are more likely to be involved in a company’s management, but policies to boost active shareholding are likely to reduce the liquidity of stock markets and increase risks run by small investors (Bhide, 1993). Liquid markets may also weaken commitment of the investors and reduce their incentives to exert corporate control by overseeing managers and monitoring performance and potential of the company. According to this view, enhanced stock market liquidity may actually hurt economic growth (Levine and Zervos, 1998). These problems are further magnified in emerging market countries with their weaker regulatory institutions and greater macroeconomic volatility.
Critics of the stock market further argue that according to the efficient market hypothesis the stock market prices should reflect all currently available information about fundamentals. Under this condition, the stock market develops its own speculative growth dynamics, which may be guided by irrational behavior. This irrationality is expected to adversely affect the real sector of the economy as it is in danger of becoming the by-product of a casino. Moreover, critics also suggest that the stock market may undervalue the long-term investment; managers are not encouraged to undertake long-term investments since their activities are judged by the performance of the company in financial assets, which could harm long-term prospects of companies (Yartey and Adjasi, 2007).

3.3 Studies on the Determinants (Prerequisites) of Stock Market Development
3.3.1 Macroeconomic Determinants

Recent theoretical and empirical research has revealed that both institutional and macroeconomic factors are important in stock market development. For example, Pardy (1992) underscored that establishing sound securities markets requires institutional development that is a substantial task for many developing countries. Prerequisites for the development of securities markets include: (a) a sound and stable macroeconomic environment conducive to the supply of quality securities; (b) a solid legal, regulatory, and institutional foundations. Such an infrastructure must take into consideration to provide the following: (i) certainty about property rights and contracts; (ii) transparent trading and other procedures and public disclosure by companies of all information relevant to the value of their securities; (iii) protection against unfair practices by insiders and intermediaries; and (iv) protection against the financial failure of intermediaries and market institutions such as clearing houses.

Demirguc-Kunt and Levine (1996), too, concluded that the development of a well-developed banking sector is important for stock market development in emerging markets. At the early stages of its establishment the stock exchange is a complement rather than substitute for the banking sector. Developing the banking sector can promote stock development as demonstrated by the experiences of many East Asian countries.
In a sample of Latin American and Asian countries, Garcia and Liu (1999) found that sound macroeconomic environments, high income level, banking sector development, domestic savings and domestic investment are important determinants of stock market development in emerging markets.

Ziorklui (2001) showed that the development of a viable capital market in Tanzania depends on viable private sector firms that are willing to participate in the stock exchange in the form of listing firms to raise long-term capital. A viable and developed capital market relies on individuals, institutions, and corporate demand for securities issued in the capital market. These institutions include institutional investors, insurance companies, financial institutions, mutual funds, pension funds, and other corporate bodies. The transition from a repressed financial regime to a market-oriented financial system will be greatly enhanced by the role of the government in providing an enabling environment. At the minimum, the government should ensure a more conducive macroeconomic environment that can support the institutional framework which is necessary for the development of a well-functioning capital market. Macro-economic environment refers to the type of the economic system, i.e., whether it is a free-market or regimented economy, nature of economic policies of the government, the legal framework as well as the institutions governing the economy and also the status of the economy in terms of physical and financial performance. Additionally, the presence of a dynamic private sector that is motivated to participate in the development effort of the country is also very essential for private sector development.

According to Calamanti’s studies of Francophone African securities markets in 1983 development of these markets in Côte d’Ivoire, Morocco, and Tunisia during the research period (mainly the 1970s) required higher levels of domestic savings (particularly private savings) combined with more even distribution of wealth and more industrialized and diversified economies (Irving, 2005).

Ben Naceur et al (2005) identified the main macroeconomic determinants of stock market development using a sample of twelve Middle East and North Africa (MENA) region countries over a varying period. The researcher found that saving rate, financial intermediary, stock market liquidity and the stabilization variable (inflation change) are the important determinants of stock market development, while
income as well as investment does not prove to be significant. In addition, they found that financial intermediaries and stock markets are complements rather than substitutes in the growth process. The researcher suggested promoting stock market development in the region, it is important to encourage savings by appropriate incentives, to improve stock market liquidity, to develop financial intermediaries and to control inflation. Yartey (2007) also found that every one percentage point increase in the financial intermediary sector increases stock market development in Africa by 0.597 percentage points accounting for macroeconomic stability, the level of economic development, and the quality of legal and political institutions.

Robert (2008) indicated that the important actions that facilitate the development of stock exchanges are:

- Establishment of macroeconomic stability and development of a funded pension system which enables the growth of institutional investors in the market.
- Floating of the substantial enterprises owned by the government on the stock exchange through a public offering of some of their shares.
- Passing and implementation of sound securities and related laws and the establishment of efficient regulators to implement them.
- Removal of tax disincentives for investment in securities.

Yartey (2008) examined the institutional and macroeconomic determinants of stock market development using a panel data of 42 emerging economies for the period 1990 to 2004. The researcher found that macroeconomic factors such as income level, gross domestic investment, banking sector development, private capital flows, and stock market liquidity are important determinants of stock market development in the emerging market countries. The results also show that political risk, law and order, and bureaucratic quality are important determinants of stock market development because they enhance the viability of external finance.

Silva (2008) found that macroeconomic, fiscal and monetary policies need to be harmonized to achieve a stable economy which is a pre-requisite for the development of the domestic debt market. In addition, several policy initiatives and targeted reforms are necessary to strengthen institutional infrastructure and remove impediments in order to foster efficient functioning and sustained growth in the bond market, particularly the corporate bond market. With regard to the institutional
infrastructure, establishing rating and underwriting agencies, trading platforms, clearing and settlement systems, regulatory environment are some of the major requirements. Policies to develop a diversified institutional investor base will create and ensure sustainable demand for bonds. In particular, pension funds and mutual funds not only create demand for fixed income securities but also contribute to increase financial innovation, improve corporate governance, and enhance competition in the bond market.

Conradi (2008) provided an overview of the capital market development in Central Asia, particularly in Azerbaijan, Kazakhstan, the Kyrgyz Republic and Uzbekistan. He presented disaggregated data to assess the role of capital markets in resource mobilization and finds that, in 2007; the amount of capital raised through securities issues was equivalent to five percent of gross domestic product (GDP) in Kazakhstan, around two percent of GDP in the Kyrgyz Republic, and one percent of GDP in Uzbekistan. The study discussed factors that have facilitated or constrained capital market development. The results found that certain areas may have to be prioritized to accelerate capital market development in Central Asia such as market infrastructure, legal and regulatory framework, privatization policies and institutional investors.

Andrianaivo and Yartey (2009) also examined empirically the determinants of financial market development in Africa using panel data for 53 countries for the period 1990 to 2006 with an emphasis on banking systems and stock markets. The results show that income level, creditor rights protection, financial repression, and political risk are the main determinants of banking sector development in Africa, and that stock market liquidity, domestic savings, banking sector development, and political risk are the main determinants of stock market development.

3.3.2 Institutional Determinants

Institutions can be defined either as a set of agencies, rules and norms that shape the social, political, and economic interactions between the members of the community, or as organizational institutions such as political, economic, social, and educational bodies. Chuppe and Atkin (1992) pointed out that the regulations such as disclosure requirements for public companies, complemented by good accounting
standards, along with credible contract enforcement and restrictions on the intermediaries licensed to participate in trading are very essential for the development of securities market. They also see a role for foreign institutional investors in facilitating securities market development since the activities of these investors tend to be less affected by information asymmetry than individual investors and can improve information flows about company prospects.

A number of economists such as Erb et al (1996) and Diamonte et al (1996), showed empirically that political risk is an important factor in investment decisions and that it strongly affects the local cost of equity, which may have important implications for stock market development. La Porta et al (1998) found by using data from forty-nine countries that institutional variables such as rule of law, property rights and one-share equal one-vote norm are important predictors of stock market development. They also found that the importance of regulating the conflict between controlling shareholders and outside investors to further the development of capital markets. They concluded that the quality of shareholder protection is correlated with the capitalization and liquidity of stock markets in 49 countries around the world.

Lombardo and Pagano (2000) found that total stock market returns are positively correlated with overall measures of the quality of institutions, such as judicial efficiency and rule of law, controlling for risk, lack of government corruption and the quality of accounting standards. They also found that dividend yields and earning-price ratios correlate positively with judicial efficiency and rule of law, controlling for risk and expected earnings growth. Moreover, Regulations concerning information disclosure, accounting standards, permissible practice of banks and deposit insurance do appear to have material effects on financial development (Mayer, 2001).

Kibuthu (2005) explained that the effective functioning of capital markets requires the following: firstly, the existence of an exchange, clearing and settlement system and the existence of a legal system to enforce contracts, followed, by availability of information on financial soundness and future prospects of companies. In addition, governance of corporations in a manner which gives investors confidence that their funds would not be stolen or wasted, is very crucial to infusing investor confidence.
Other study by Hooper et al (2009) found out that the quality of governance is positively associated with financial market performance. Accordingly, countries that have efficient institutional environments have higher returns on their stock markets and lower levels of risk. The result unmistakably supports the view that a precondition for financial market development is the improvement of the institutions which govern the process of exchange.

Yartey (2008) also concluded that the political risks and the quality of institutions are strongly associated with the growth of the stock market capitalization. The researcher also indicates that the development of institutions of good quality (resolution of political risk) can be an important factor in the development of stock markets in the emerging economies. Andrianaivo and Yartey (2009) also found powerful impacts of political risk on both banking sector and stock market development. They suggest that resolution of political risk may be important to the development of African financial markets.

Finally, Billmeier (2009) explained that institutions may affect the stock market development in two ways. First, through the improvement of institutions, which are associated with greater transparency, less corruption, better protection of property rights and promotion of investor confidence that would lead to high demand for securities. Second, better institutions promote economic growth in general, and thereby strengthen the market fundamentals that lead to a high degree of development of stock markets.

3.4 Hurdles to Development of Small Stock Markets

From various studies, a number of adverse factors have been identified and generalized for most countries. For example, Bekaert (1995) included high and variable inflation rates and exchange controls among the major economic impediments to equity market development and integration globally. Furthermore, the profitability of corporations can experience sharp movements due to unexpected changes in economic policies such as monetary policy, fiscal policy, exchange rate policy and trade policy. Hence, it is expected that stock markets in countries with volatile macroeconomic conditions would also have volatile price indexes and market capitalization.
Jefferis (1995) studied and assessed the role of the Botswana Stock Exchange (BSE) in the financial and economic development during the period 1989-1993. The researcher recommended addressing the impediments of such as the market’s narrowness and lack of adequate supply of shares and securities available to local investors by increasing the use of the Botswana Stock Exchange in carrying out privatizations. Chalk et al (1996) found that the 13 Middle East and North Africa (MENA) countries included in their analysis have made significant progress in financial deepening. But in most of these countries, financial markets are thin and tightly regulated, government ownership is prevalent and market forces play a limited role. In comparison, Jbili et al (1997) concluded that the financial sectors in the Arab states of the Gulf Cooperation Council (GCC) are more developed, technologically more advanced, and better integrated into the world economy than the rest of the MENA region. This finding reflects the substantial difference in the degree of financial development in the region.

Ogwumike and Omole (1997) observed that stock exchange in Nigeria is constrained by government policies that do not promote mobilization of industrial finance. At one time, it was noted that interest rate policies favored growth of the money market rather than the capital market. The problem of awareness is also cited as a reason for reluctance of companies to go public. Furthermore, insufficient disclosure of information is due to the underdevelopment of information technology and manpower training.

Using survey data, Osei (1998) examined the institutional factors that affect the development of the Ghana stock market. The study concludes that there are certain factors that are crucial for capital market development such as income level, education, and information about the capital market. It was also opined that the legal and regulatory framework that ensures protection and security of investors is important.

Dawit (1999) indicated that one of the major concerns by investors is the inadequate institutional system and operational procedures. Many stock exchanges are still in the process of developing, modernizing, or streamlining operational procedures. Therefore, trading and pricing mechanisms, clearing and settlement, and share registration and custody practices remain outdated.
Kimura and Amoro (1999) found that the key factors that impede stock exchange development in Nairobi is the general lack of awareness and information on the role and functions and operations of the stock market as well as lack of a sufficient number of products instruments to attract public investment. They also found that banks tend to indirectly discourage stock exchange as a means of raising capital because they play the dual role of being investment advisers as well as lenders. They concluded that all players in the arena must change their approach to promote capital market development. Stock market should play an increasingly educational role, and the Capital Market Authority and the regulatory agency must change the approach from the sometimes heavy-handed type of control to a more proactive, creative and supportive role in order to assist in the creation of a more vibrant and forward looking capital market environment.

Nashashibi et al. (2001) also found that most Arab countries had made progress over the past decade in financial reform but were still at an early stage in the process. Their financial systems are dominated by banks and, in some, by public banks; and capital market development is hindered by legal, institutional, financial, and economic factors.

Ziorklui (2001) indicated that in most of Sub-Saharan Africa (SSA) countries, the capital markets remain small and less developed. A major constraint is the financial repression together with a weak and unclear legal framework. The results of survey confirmed that the demand for securities in Tanzania is affected by various factors. These include the living standards of the local population, perception of risk in the market, tax considerations, and attractiveness of yields on capital market products as compared with alternative investment products. The level of public confidence in the financial sector also affects the demand for securities in the stock exchange. The results showed that out of 46 employees interviewed, only 4.3% mentioned that they had bought shares in the Dar es Salaam Stock Exchange (DSE). This represented a small percentage of individual participation in the stock exchange. The results also show that introduction of new products through privatization and introduction of debt instruments would enhance their attractiveness. The government’s policy of tax incentives and fiscal discipline would also enhance the confidence of investors in the DSE.
Abumustafa (2002) pointed out the most serious problem associated with many emerging markets, especially Arab markets are: inadequate liquidity, restrictive regulations on banking system which adversely influence stock markets, restrictive regulations on investment of pension assets, investment being limited to local investors, which in the long run would expose the economy to high local market risk, reliance on privatization as first solution to promote growth, restrictions on foreign portfolio investment, and insufficient protection for new investors from insider trading.

Abdel Shahid and El Serafie (2002) emphasized the need for Arab stock exchanges to change the governance structure in order to be more effective in terms of cost and transparency. The researchers conclude that it would be better if Arab Exchanges are first restructured and become private before thinking of regional integration/alliances. This is because the private exchanges can judge better which alternatives would be best with the long-term strategies rather than having a government-imposed integration that are doomed to failure.

Abu-Sharia and Junankar (2003) analyzed the impact of stock markets on economic growth in Arab countries using panel estimation techniques. They found that there was a positive relationship between stock market development as measured by the log of the turnover ratio and economic growth. However, this relationship was statistically significant only at the ten percent level. They also found that the lesser the public rights, the slower the growth rate. They suggest that a pursuit of liberalization in terms of civil and public rights should help hasten economic growth as well as being desirable in its own right.

Creane et al (2004) found that in much of the MENA region, the quality of institutions, including the judicial system, bureaucracy, and property rights, was poor. This hinders banking and financial activity as well as investment, and hence growth. In several countries, the judicial system is susceptible to political pressures and long delays, resulting in poor legal enforcement of contracts and loan recovery. They also found that of the 20 countries surveyed, it was easy only for two countries to recover loans through the judicial system. The International Country Risk Guide assigns a low rank to countries in the region for the quality of the bureaucracy, at a level significantly below that of more industrialized countries, including the fast-growing
newly industrialized Asian economies. Property rights enforcement tends to be weak in the region as well. On the Heritage Foundation’s index of private property protection, only one country in the region (Bahrain) has a rating of very high protection, and two (the United Arab Emirates and Kuwait) have a rating of high protection.

Similar to the results presented above, the Heritage Foundation notes significant government involvement in banking and finance in the region. Its index (which weighs government ownership, restrictions, influence over credit allocation, regulations and freedom to offer services in the financial sector) rates only one country (Bahrain) as having very low government restrictiveness in the financial sector for 2002, and two (Jordan and Lebanon) as having low government restrictiveness. (See Table 3.1).

Table 3.1
Middle East and North Africa: Ranking of Financial Development*

<table>
<thead>
<tr>
<th>High</th>
<th>Medium</th>
<th>Low</th>
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<td>Bahrain</td>
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<td>U.A.E.</td>
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* Based on an index of qualitative and quantitative data; 2000–01 data; scoring 0–10, with 10 being the highest level of development within each category, the countries are arranged in alphabetical order.

Study conducted by ESCWA (2004) showed that structural weaknesses and institutional obstacles to the development of capital markets are indeed numerous and daunting in Economic and Social Commission for Western Asia (ESCWA) region including Arab countries. First, markets in the region are very small in size and limited in their role of mobilizing and allocating resources. The small size and limited role of capital markets can largely be explained by the very narrow range of
investment instruments traded, usually shares and a few bond markets in private
issues; the small number of listed companies; and the limited number of securities
available for trading, owing to the pervasive ownership of securities by public entities,
and family-owned and closed-type private enterprises, which are usually reluctant to
go public.

There are also other impeding factors, including the inadequacy of various
legal, financial and organizational infrastructures for prudential regulation and
minimal transparency of the system; poor information disclosure; inadequate market-
supporting infrastructures, namely, brokerage firms, auditing firms and credit rating
agencies; and the lack of training and skilled manpower in the financial sector. Some
of these issues are scrutinized as part of policy options for developing sound and
efficient financial markets in the ESCWA region.

Achy (2005) assessed empirically the effect of domestic financial
liberalization on the economic performance in the specific case of Middle East and
North Africa (MENA) countries. He found that domestic financial liberalization
impacts negatively of the private investment and economic growth in Egypt, Jordan,
Morocco, Tunisia and Turkey over the 1970-1998 period. Also, Neaime (2005)
explored whether MENA markets can offer international investors unique risk and
returns characteristics to diversify international and regional portfolio. His empirical
evidence suggested that the GCC stock markets still offer international investors
portfolio while other emerging MENA stock markets like those of Turkey, Egypt, and
Morocco and to a lesser extent Jordan have matured and are now integrated with the
world financial markets.

Irving (2005) pointed out that traditional factors such as low stock exchange
turnover rates, the small number of local investors, the small number of listed
companies, and the limited number of potential issuers can pose significant
impediments to the development of securities markets in less developed economies.

Khamfula (2005) indicated that many African capital markets face a serious
obstacle to the efficient use of their savings, and thus to their overall economic
development. To improve the situation, the results proposed the following policy
recommendations: removal of impediments to capital market development,
improvement of the financial system infrastructure, sound economic policies that stabilize the exchange rate and prices to help attract foreign investors, encouragement of family-owned firms to go public and, most importantly, liberalization of international capital flows. The study also suggested privatization and currency union as enhancers of capital mobilization for real sector investment in Africa.

ESCWA (2005) reported that developing countries across the world face obstacles in terms of forming viable domestic capital markets. While emerging stock markets in developing countries have the advantage of being close to the investor and of offering investment opportunities in the local market, there are a number of characteristics that are typically lacking in the stock markets of developing countries, including the following: (a) transparency; (b) accountability; (c) liquidity; (d) low transaction costs; (e) investor protection; and (f) modern clearance and settlements procedures. These issues must be addressed if the stock markets of developing countries are to compete and/or integrate with international financial markets. The study concluded that enhancing the effectiveness and efficiency of the capital market entails, among others, certain specific measures aimed at the following.

(a) Improving the legal environment with regard to market access;
(b) Ensuring fair trading and transparency in securities transactions;
(c) Developing central securities depository and investor protection schemes;
(d) Enhancing capacity to enforce securities regulations;
(e) Improving information disclosure systems; and
(f) Improving clearing and settlement systems.

Mala and White (2006) found that the non-availability of resources like finance, expertise and technology, are really considered to be among the most prominent challenges facing Fiji’s stock market. This is also considered to be the obstacle in terms of upgrading the stock market because without the availability of finance, human expertise and technology, it is really difficult to introduce changes in the stock market.

Yartey and Adjasi (2007) pointed out that African stock markets suffer from the problem of low liquidity. They therefore showed that the main institutional and infrastructural bottleneck of African stock markets is the use of slow manual systems.
Even though markets are gradually adopting electronic systems, there are still substantial member of African stock markets which trade manually and use manual clearing and settlement. Similarly, most markets do not have central depository systems, whilst some markets still have restricted foreign participation. Such bottlenecks slow down trading and induce inactivity.

Gentzoglannis (2007) examined the link between the degree of financial openness and economic growth and documents that this link exists only in the group of high income countries but this relationship is rather weak for the low income Middle East and North Africa (MENA) economies. Privatization alone, although necessary, is not enough to spur economic growth.

Piesse and Hearn (2008) explained that the establishment of a successful stock market in a developing economy can be a major source of economic growth. It provides development finance by channeling domestic savings and attracting foreign investment. However, this objective is not always met, particularly in very small markets where there are barriers to efficient market operations. A case study of Swaziland and Mozambique illustrates that any potential gains to the domestic investment community are limited if there is insufficient liquidity and the political economy is such that ownership is not truly dispersed but rather remains in the hands of social elites. They opined that potential growth of small developing markets is further severely constrained by poverty and wealth inequality and consequently the impact on development is minimal.

Singh (2008) reported that most African stock markets are small, with few listed companies, low market capitalization, low turnover of shares and many countries in Sub-Saharan Africa have created stock markets in the last fifteen years. The researcher concluded that there is no viable future for the small Sub-Saharan African stock market in the era of globalization and ever-closer financial integration in the world economy.

Mckinley (2008) showed that there are a number of other reasons why underdeveloped countries such as Laos and Somalia do not have stock markets or have ones that are small (Vietnam, Ecuador) compared to the size of the economy. Low economic growth, high inflation and low savings rates discourage the creation of
strong capital markets. Added to those constraints are: weak regulations on investment, inadequate bankruptcy laws and a lack of protection for investors all of which work against the development of robust capital markets in developing and transition economies.

Ben Naceur et al (2008) found that within the Middle East and North Africa (MENA) region there is substantial variation in the degree of financial development; some countries are fairly well advanced, whereas a few others have significant room for improvement. As a group, MENA countries appear to perform relatively well on the regulation and supervision as well as on financial openness. However, they need to do significantly more to reinforce the institutional environment and promote non-banking financial sector development. Compared to most other developing country regions, the MENA region performs well, but it ranks far behind the industrialized countries and East Asia.

Using annual data from 11 MENA countries over the periods 1979-2005, Ben Naceur et al (2008) documented an improvement in the financial system indicators following stock market liberalization. Their empirical findings, however, indicate that stock market liberalization has no cognizable effect on economic and investment growth. While the impact on stock market and banking sector development is negative in the short-run, it turned positive in the long-run. They concluded that reforms should first and foremost start in the domestic economy before opening it fully to foreign participation.

3.5 Past Studies on Establishing a Stock Exchange in Yemen

There are very few studies which can be found in the documents of national conferences or in Yemeni journals. Here is a brief account of some of the most significant of these studies. Bashrahil (1997) pointed out the privatization trends in Yemen as one of the most critical components of the economic reform program. He has highlighted the importance of the stock market as a key anchor for the success of the privatization process in Yemen. The researcher found that the Yemeni economy is currently equipped to establish a stock market and it would be economically viable. A report by the Arab Monetary Fund (1998) reviewed the status of Yemeni securities market and made certain requirements to ensure a successful stock market like macroeconomic stability, attractive legislative environment, financial intermediary
development, increasing the level of awareness about investment and sufficient demand for and supply of securities.

Al-Haori (2001) pointed out that there are some obstacles which would affect the establishment of a stock exchange in Yemen. These included the limited potential demand for and supply of the securities, the failure to complete the legislative and legal frameworks, and the absence of financial intermediation and private institutions. In this context it is pertinent to mention that the World Bank's perspective that Government of Yemen should focus on the following factors before stressing the establishment of stock exchange: strengthening of the banking sector, increasing the capital of insurance company, development of investment institutions and pension corporation, independent judicial system and attracting foreign investors (Al-Khawi, 2002). Al-Sabahi (2002) found that the creating of a stock exchange in the Republic of Yemen is very important to the economy. He also opined that essential requirements for the market are currently prevalent and the stock market proposed in Yemen like other emerging markets will face many obstacles that may limit its growth and efficiency. The researcher recommended addressing these problems and obstacles that prevent the development of stock exchange in order to ensure the success of the stock market and thus achieve economic growth.

From all that has been mentioned above it can be concluded that an extensive volume of literature and empirical research work have shown that the stock market plays an important role in economic growth. The previous studies provided enough evidence to make a convincing case that stock market development at least creates the enabling environment for a successful economic growth. It also can be drawn from the previous section that there are differences in views among economists about the importance of the establishment of the stock market for certain countries, particularly in the early stages of development. It also can be found that most previous researches, both theoretical and empirical, have concentrated on the development, rather than the initial formation, of a stock market. Very few studies have examined the factors that impede and those that facilitate the creation stock markets in less developed economies.
In addition, from the foregoing review, it is evident that studies on the feasibility of establishing a stock exchange in Yemen are very limited and rare, and this study has not been seriously and sufficiently examined previously. Furthermore, an organized approach to stock market studies is inadequate as far as the Yemen is concerned. Hence, there is a pressing need for research in this respect.

Finally, the foregoing review of the existing literature on stock market and their relationship with economic development and also of the current scenarios prevailing in the stock markets of the countries with economic and social features similar to those of Yemen may be concluded with the observation that, there is need for a thorough study of the features of the Yemeni economy and the pre-conditions necessary for the establishment of a stock market in Yemen. The ensuing chapters attempt to study these aspects.