

## CHAPTER TWO

# THE OVERVIEW OF LIBYAN ECONOMY AND LIBYAN STOCK MARKET (LSM)

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## CHAPTER TWO

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#### 2.1 INTRODUCTION

After highlighting the purpose of this study and explaining the structure of the thesis in chapter one, this chapter presented the main features of the Libyan economy in 1951 when Libya became independent. There is also concentrating on the 20-year before the current time, when the United States (US) and the United Nations (UN) imposes economic sanctions on Libya. The first section provides an overview of Libyan economy and some related subtitles. Next section would be addressing the financial market and stock markets histories in general. The third section pointed more accurately to explain LSM history, its characteristics, and the stages of its development and concluded by the positive effects of LSM on economic growth in Libya. The last part of this chapter includes a summary, and conclusion.

The relation between the stock market and economic growth is widely studied and debated issue. However, in case of LSM is established quite recently, enough data about the market are unavailable. Therefore, this study will try to examine this linkage using some LSM indicators such as a market capitalization ratio (MCR) as a size measure, liquidity indicators consist of Turnover ratio (TR), and LSM Index (IDX). Meanwhile, Real Gross Domestic Product (RGDP) is used as an economic proxy. The previous literatures discussed the LSM performance, but this study will be the first attempt to measure and evaluate the role and effect of LSM on Libyan economic growth during the period 2008:M4 – 2011:M2.

#### 2.2 THE OVERVIEW OF LIBYAN ECONOMY

Libya is one of the developing countries, it has a large area and low average of the population and large quantity of natural resources, oil and gas. To understand the Libyan economy, it should know its nature and features is and whether it is capitalist

or a socialist economy or it is a mixture of the both types. Also, to know whether it is an open nature directed by free market forces or centrally-controlled economy, and if it is market oriented or state-controlled. In addition to that, it should be known if it is a mixed economy based on Islamic principles and socialist principles. In this section the ground from history, geography and the prime traits of the Libyan economic modification agenda with a few essential contents would be depicted.

In his study Aljbiri (2008) demonstrated that the Libyan economy witnessed a rapid expansion during the 1970's and also during the early 1980's, when real GDP grew by more than 10 percent on average. Oil revenues mainly contributed to this expansion. In the mid 1980's the average economic growth was slow, and Libyan government began to experience recessionary trends. These trends are seen in the later of oil price breakdown and the Gulf war in the period 1990/1991. Indeed the instability of economic policies and the non-stop changes of these policies during the last three decades contributed to complicating the issues and made it even harder to answer above questions. However, there are three phases which describe the features of the Libyan economy as follows:

1. This phase started in 1970, and it witnessed a transition to socialism by nationalising oil companies and making plans and allocation for development especially in industrial and agricultural fields.
2. It started in 1980 when the government made a discussion stop the private sector working in Libya that was done by the law 4/1980 and by collecting and redistributing the wealth slogan. The target was to create an instrument that would control and orient the private sector.
3. This phase started in 1999 possesses the goal to find other income sources instead of oil to achieve the growth target in non-oil sector.

Libyan economy has a strong linkage with the rest of the world, especially in the trade exchange field. As such, the country's foreign exchange earning relies largely on the crude oil exports. As the oil-rich countries in the Middle East and North Africa (MENA), Libyan economy is significantly supported by oil exports. With fluctuation and increases of the prices and revenues of the oil in the last two decades i.e. Since

1970 the country has exerted notable efforts to achieve an economic diversification aim. These efforts have caused sustained investment in the non-oil sectors, particularly in agriculture, manufacturing fields and other sectors of the economy.

On the other hand, Libyan economy was plagued by many problems. Over-dependence on the oil sector has been calculated into it where oil records for 95 percent of the GDP. These problems make it rank adding to its oil accounts for 95 percent of the GDP; these problems make it rank poor among other advanced economies. On top of that, there was an economic embargo imposed on Libya in the nineties after its transition to a socialist system in the eighties, which resulted in the central economic situation in Libya for the last four decades.

Libyan economy also suffered from many negative aspects which aroused, as a result of political and financial crisis. Different sanctions were imposed on Libya by the US and the UN. The US banned imports of Libyan crude oil in 1981, and after that extended it to include direct trade, commercial contracts and travel activities. The UN made an embargo, which began in 1992 after the accusation of two Libyan citizens involved in the crash of an American aeroplane in Lockerbie in Scotland in 1988, these sanctions, have negatively impacted over health, education, oil sector and other aspects of Libyan people's lives. This embargo has been easing in 1999 and was completely declined in 2003 after the country accepted its responsibility for the crash while the US embargo was declining in 2004.

In June 2003 President Al-Qaddafi declared that the country's public sector had failed and called for the privatisation of the oil sector, pledging to take Libya into the World Trade Organisation (WTO) by establishing the former Trade and Economy. In October 2003, the Prime Minister Tayeb Assafay declared a list of 360 firms in a variety of sectors (steel, petrochemicals, cement and agriculture) which were to be privatised (Energy Information Administration/Department of Energy, 2005). This function was executed in three stages. The first stage is that ownership of 260 factories was to be transferred from the public to the private sector at the end of 2005. The second stage was to transform 46 factories into shareholding companies in which employees and others would own shares by the end of 2007. The third stage aimed at privatising 54 factories during the period 2007/2008 (Masoud, 2009).

There are many secondary factors that have helped to exacerbate the weakness of the Libyan economy. The important one is that it is a consumer based economy, which consumes large returns of crude oil exports. There is no export based industry apart from oil or oil- based derivatives in Libya. Moreover, there is another factor that has an adverse impact on the effectiveness of the Libyan economy; it is the scarcity of human resources that constitute strong support for the success of any economy. The Libyan economy depends solely on the foreign labour. The workers come from several countries like Egypt, Sudan, Turkey, Chad, Niger, Tunisia, Morocco, Syria, etc., for working in all sectors. The percentage of non-Libyan workers employed in Libya is approximately 70 percent (Zeaad, 2010).

Furthermore, because of the socialist transformation, the Libyan economy faced many problems that have brought its activities to a paralysed state that had the largest impact on the low standards of living of a large segment of Libyans who are dependent directly on the state for their income. Despite the transformations took place in the Libyan economy in the study years, there are still many restrictions on the movement of funds and goods and, therefore, the living conditions of most of the Libyans did not improve.

In addition to the aforementioned factors, another significant factor that has contributed to weakening the Libyan economy is the unavailability of the stock market. Even though the LSM was established in 2006, it was very unstable in the first two years because a smaller number of trading and of contributing companies as well. In addition, there were no private and foreign investors participating in the market. On the other hand, this step was adopted quite late, which the Libyan economy needed many years ago.

One of the LSM's publications 2009 titled "The importance of LSM in the Libyan economy" reported that the Libyan economy is currently in a transition stage, because of the rebuilding of the policies, expansion of the base of ownership and distribution of wealth of the citizens, these policies started in 1992 with the issuance of Law No. (9) On the economic activities, and the subsequent laws such as the Banking Law No. (1) For the year 1993, Law No. (5) For the year 1997 on foreign investment, and the Law No. (21) For the year 2002, as well as the Banking Act, the new law for the year

2005, this gave authority to the CBL in the licensing of foreign banks and the liberalization of interest rates on deposits and, finally, Law No. (3) For the year 2007 for public companies, which gave the public companies the freedom to prepare regulations for the administration and financial system, including salaries, as excluded it from the presence of observers and a non-financial subject to the law of the country's financial market. The main features of the Libyan economy would be explained as follows:

### **2.2.1 Historical Background in Libya**

The historical background in Libya can be viewed from two angles: geography and population; politics and economy. These two aspects are discussed subsequently in the following sections.

#### **2.2.1.1 Population and Geography**

Libya before the last revolution 2011, had another name - The Great Socialist People's Libyan Arab Jamahiriya. It is located in the heart of North Africa with a long beach of the Mediterranean Sea in south-Egypt in the east, Tunisia and Algeria in the west, and Sudan, Chad and Niger` to the south. Libya possesses a large land of about 1,759,540 sq. km (679,358 sq. ml) and there is a coastline of some 2,000 km. It is the fourth largest country in Africa, the seventeenth largest in the world and is seven times the size of the UK. Libyan climate is moderate in spring and autumn, where summer tends to be very hot, whereas the winter is cold. The climate is diverse with the Mediterranean Sea in the north, and resembles the desert climate in the south. Otherwise, Libya comprises of desert (45 per cent of it with 25 percent sand dunes), the rest of the land being arable land (19 percent), permanent crops (17 percent), and pasture (20 percent) and forest (4 percent).

In fact, Libya is rich in natural resources (like oil and natural gas) and other areas of iron ore, Sebeka salts and pastures (Masoud, 2009). Besides the oil and gas sector, other two key industrial sectors are agriculture and fishing. Libya's geographical location has helped a lot for the trade networks and exchange of goods and products between Europe and Central Africa through some Libyan local areas, such as coastal

towns and oasis. The Libyan geographical area also serves as a strategic link between eastern and western nations. The population increased from 3,225.1 thousand in 1980 to 4,524.4 thousand in 1990, 5,426.8 thousand in 2000 and reached around 6,089 million in 2007 (CBL annual reports 1980, 1990, 2000, 2007). The yearly population growth rate during the period 1975-2005 was about 2.9, due to improved standards of living, and is expected to be 1.9 percent during the period 2005-2015 (Masoud, 2009).

### 2.2.1.2 Libyan Economic History

Historical records indicate that the primitive inhabitants of Libya are Berber, a primitive tribe. The country was known as Libu in ancient Egyptian texts refers to one of the Berber tribes which lived on the west of the Nile River in Egypt thousands of years ago. On the other hand, because of Libya's located at the strategic place between Europe, Africa and the Middle East, its history has been one of the successful invaded places. From the 10th century BC, the Phoenicians occupied the west of the country. The Greeks referred to the tribesmen as Libyans and then the country's name became 'Libya'. This fact was also mentioned by ancient Egyptians during the era of Ramses II (1298-1232 BC). In the sixth century BC Carthage rose prominently as a mighty state and survived until the second century BC, after which it was overthrown by the Romans. In the fifth century Libya was seized by the Vandals, and in the sixth century, it fell under the control of the Byzantines. In the seventh century Muslim Arabs conquered Libya. At the beginning of the fifteenth century the Libyan coast had minimal control and its harbours were havens for the pirates. In 1550 in order to protect the Islamic faith from Spain, the Muslim lands like Libya, Tunisia and Algeria invited the Ottoman Sultan to extend his control to their countries. The Turkish Rule initiated since 1551 and continued until 1835 (Masoud, 2009). In 1843, the Sanussi Order settled in Cyrenaica, which is at the heart of the Bedouin tribes. By 1894s they moved to Al-Kufrah oasis from the Jaghbub oasis to control the Sahara trade routes, which passed through Zawaya. The highest degree of political and historical movement occurred within this period (Masoud, 2009).

The weakening of the Ottoman Empire led to the first Italian War against the Turkish in 1911. In 1912 the world was recognized the Italian sovereignty, Despite that, Libyans continued to fight against the Italians until 1914. In 1949 the UN voted that

Libya should become an independent country. The country contains three separate areas: Tripoli Tania, Cyrenaica and Fezzan. On 24 December 1951 Libya became the United Kingdom of Libya. The new nation became a monarchy ruled by King Idris between 1951 and 1969. His political leadership derived from his role as a leader of the religious movement established by his family under the name of the Senussi Order.

During the early years of independence in 1951 the Libyan economy was underdeveloped and dependent on the British and United States military treaties. For example, per-capita income was between 30 and 40 million US\$ annually. Due to this low rate the levels of nutrition and healthcare were very poor. The Libyan birth rate was also low (about 5.3 percent in 1952) resulting the decrease of the natural rate of population to 1.1 percent along with a 4.2 percent death rate. This overall situation caused the low standards of health care. In 1958 the great event of oil discovery occurred, and then by 1962 exports had commenced (Masoud, 2009). From that event, the economy of Libya initiated to launch several strategies as overseas firms started to gather in Libya for working in oil-related fields. This circumstance results from an acceleration of Libyan economy of the salvage phase.

### **2.2.1.3 The Transition to a Market Economy**

The newest exploration of oil in Libya results from notable differences and diversifications in the national economy. National income upgraded with great speed. After it was no more than 15 million pounds in 1950, became an estimated 52 million in 1958, then rose to 59 million in 1959. This increase of income was because of the oil. Many activities came with this, such as construction of traffic and improved wholesale and retail are very significant improvement. It was clear from statistics published by the oil companies that the total expenses of these companies during 1960 amounted to 52 million pounds. Also, that part of the increase in income was due to foreign military expenditures, which spent on foreign soldiers stationed in foreign bases in Libya, in addition to the foreign aid received by the country from the United States (Al-Raed Al-Arabi 1961).

Because of the decline in the oil prices, Libyan oil revenues decreased from USD 21 billion in 1980 to USD 6.5 billion in 1986 (Vandewalle, 1996). This decline of income negatively affected the ability of the country to continue with its previous policy (Masoud, 2009). The government applied austerity policy and limited the list of imports by cutting unnecessary commodities. In spite of these efforts, austerity policies did not help to save much money and the government had to reform its previous economic policies (Altunisik, 1996). This section focuses on the economic reform programs in Libya, especially the privatisation as one of the economic reform elements, from its commencement in 1987 until 2008.

Libyan decision makers found that Libya requires a comprehensive medium-term strategic plan to achieve the reform programme of its economy and to benefit itself from the economic sector and potential financial resources. They reported that this strategy will be through the economic diversification and reduction of dependence on the oil sector. For this reason, they proposed some strategic policy which would maintain macro-economic performance, stability and rationalize the use of the country's oil wealth. It would in turn accelerate the transfer of this economy to a market-based economy and provide a stable base for the non-oil resources development. The necessary steps to achieve this target are restoration of the private sector confidence and enhancement of the country's economic potential. This stage requires a sound macro-economic framework which will send clear signals to the market, possessing the commitment of the authorities willing to reform. International Monetary Fund (IMF) provided technical assistance in the areas concerned with monetary policy, the restructure of the bank, banking supervision, tax policy, and the administration of the revenue and statistical activities (Aljbiri, 2008). This measure would implement the necessary reform actions. There are major steps to achieve this priority, which would lead towards economic reform programme.

#### **2.2.1.4 Deregulation Programme**

Libyan government started to bring change through making new laws and regulations to motivate and organise the private activities and productive enterprises Co ownership, as well as the shareholding companies. This new form of ownership which named as "Tasharukiya" was in the medium and small industries, it takes the shape of

the arrangement between private sector and state ownership, whereas each worker has a share of capital and profit. This procedure commenced with the significant reform made by law No. (8) Of 1988 which concerning at the first time in a number of economic activities in 1977. This law is based on sentences related to economic activity that laid the basis for rebuilding the Libyan economy. The first condition allowed individuals to separately or co-operatively perform the economic activities, including the products and services distribution, which were in the past limited only to public companies. The second clause addressed individuals, families, land ownership and factories, etc. The fourth part asserted the application of commercial law and its affiliated regulations and decisions taken on issues which were not covered by law (Shernanna, 2013). As a result of that, the private sector and investment were limited, and the economy was also under the government's control.

After that, the law No. (9) In 1992 issued on the practice of the Libyan business environment which allowed the joint-stock company's establishment that called "Sharikah Musahimah" or in other words "Contribution companies", this refers to collective ownership and creation of co-operatives where some partners contribute labour and capital (Vandewalle, 1998). During the period from 1987 to 1989 the government announced a new regulation for the first time after 1977 to decrease the private sector investment role in Libya. The "Tashrukiya" system aimed at encouraging the small-scale private sector to participate in the retail trade, small industries and service as a mean to reduce the inefficiencies in these industries (Altunisik, 1996). For instance, in the industrialized sector systems of 102 public institutes were replaced by "Tashrukiya" structure and additionally 10233 new private institutes were established (Masoud, 2009).

Nevertheless, neither of these laws was sufficient to improve the private sector because they merely caused a small growth in the service and crafts sector while more important sectors remained on hold.

By the second half of the 1990's and the beginning of this century, another set of rules and regulations were launched by the General Public Conference, which is the highest authority in Libya GPC. This initiative aimed at expanding the role of the private sector, establishing private banks, adopting the wholesale trade liberalisation and

directing its activities to economic reform. In addition, these rules were imposed targets foreign capital investment and achieving the required financial stability of the Libyan economy. Among these laws, the following regulations provided most significant contribution to the Libyan economy (Aljbiri, 2008).

1. Law no. 1 of 1993 it was for banks and credit finance that allowed the individuals to have the private ownership of commercial banks, besides allowing citizens to establish co-operative companies (banking companies), on condition that the company's capital should not be more than about LYD 10 million. In addition, it permitted foreign banks to establish their representative agencies and offices in Libya and allow foreigners to have bank accounts by foreign currency. Clause 13 of this law dictates that the Central Bank is responsible for buying and selling and guaranteeing bonds and stock issued by the general treasury, payable within at least 15-year period.

2. Law no. 21 of 2001 defines the minimum limit of shareholder number in shareholder companies, the number should not be less than 25 shareholders to establish a shareholder company if the total capital did not exceed one million LYD. This positive procedure facilitated the establishment of shareholder companies for individuals. This law came after cancelling the law No. (8) in 2001 which assumed a minimum of 500 shareholders for the establishment of a shareholders' company that presented an obstacle against the formation of such companies.

3. Law no. 1 of 2004 focuses on the adjustment of a number of rulings of the law no. 21 of 2001 (The previous law) on various economic activities. The above law facilitated the establishment of shareholding companies by enabling them to issue carrier stock not only by name. There is an expectation that these companies will be allowed to lower the minimum limit of shareholders and increase the percentage of individual holdings.

4. GPC Resolution 134 of 2006 concentrated on the establishment of the LSM system issuance. The Libyan government realized that the establishment of the LSM is a significant step on the developing financial resource path through the establish capital market that is a critical issue to achieve the aim of the economic reform programme in Libya.

On the whole, a new economic reform stipulated the establishment of shareholding companies that lead the trend to the economic reform in all sectors. The entire process continued more than 12 years before reaching the current state, starting with law No. (9) In 1992 followed by law No. (8) and No. (21) in 2001, and law No. (1) in 2004. These laws helped to facilitate the establishment of shareholding companies and allowed to decrease the minimum limit of shareholders and reduce the individual's share as dictated by law No. (21) In 2001 (Masoud, 2009). In the year of 2002 Alqadhafi decided that the government control and intervention in the economy will be widespread, which means the price-setting was still under the government control. So, it was difficult for these firms make a profit because of various obstacles which prevent them from developing themselves and improving their performance (Alafi & Bruijn, 2010). On the other hand, in 2005, the Ministry of Planning reported that, the "Tasharukiya" system was not successful because many firms suffered from a weak performance while some of them even continued with loss-making, in a way, that ensures the improvement of their performance. They collected with this system with various shortcomings like prior debts and their labour force intact.

#### **2.2.1.5 Privatisation Programme**

In the early 1990's, Libya witnessed many difficult circumstances; it was suffering from the effects of international economic sanctions because of the Lockerbie Airplane issue, where the sanctions continued until the year of 2000. As a result, privatisation became one of the primary policies adopted by the IMF and the World Bank as one of the economic reform parts. This measure was expected to recover the deteriorating economic conditions, especially in developing nations. With that transfer of ownership in Libya began in 1987 by the People Committee Resolution No. (447) on 1987, based on one of the three Green book chapters (Partners not Workers), law No. (9) in 1985 and GPC Resolution No. (313) of 2003, by sharing the returns on investment with employees. Then the profits were divided among the various productions (worker, machine, capital) according to a specific accounting programme.

After that, the government went further to introduce its second economic reform program, which is the concept of Sharika Musahima (joint-stock company). This allowed private companies to open accounts by foreign currency and to import

equipment (Vandewalle, 1998). The government expected that this procedure will surpass the previous privatisation experience because the burden will divide between the public and private sectors through reduction of government's involvement the economy. To achieve this goal, the central committee was established. It consisted of a secretary, chairman, and members, who were specialised and expert in their respective fields. In the industrial sector, for example, 196 public firms were privatised, and 7483 new private firms were established (the Ministry of Industry, 1992). In addition to boost in the number of transforming units which reached 295; their asset value was around LYD 98,000,000. The transformation procedure continued from 1987 to 1992. This step had many positive results, such as the return of 75 percent of the assets' value owned by these units, with transfer 30,000 products to the national sector (Masoud, 2009).

In its report for the year of 2005, the Ministry of Planning reported that the performance of the privatised firms was degraded, and the production was almost similar to the privatisation. The report provided reasons similar to the first economic reform ones. With a lengthy procedure of licensing, this situation led to the reluctance of foreign investors to invest their projects in Libya.

Following the stop of the 1992 transfer process, there was an eight-year gap until it resumed with the subsequent GPC decree No. (313) in 2003, which approved the restructuring of the public sector's programme and enhancement of the ownership base. In addition to that, the Committee issued the list of designated public companies and economic entities' No. (31) of 2003. The list included a time frame for the transfer process guided by legal and administrative framework concerning partial and overall levels. Ownership was transferred from 360 economic units into agricultural, industrial, livestock and marine fishery sectors; the value of their total assets equalled LYD 8 million, and 100,000 plus employees worked in these economic units. This programme was over time, between 2004 and 2008 in three stages. In the first stage 145 firms were transferred in the industrial sector while the lowest transfer was in the marine fishery. Meanwhile, in the second stage the highest transfer was in the agriculture sector. The lowest transfer in the third stage was in the livestock sector that

witnessed the lowest level of transfer in most of the stages (Masoud, 2009; Shernanna, 2013).

### 2.2.1.6 Liberalisation Programme

During the five years before reaching 2009, Libya has witnessed many transformations. Until recently the country had no private sector. Conversely, foreign firms could not own or rent the property from individuals. In addition, the purchase and distribution of consumer goods were a state-controlled monopoly. In 1987, the initial signs of economic liberalisation allowed the Libyan government to find the Tasharukiya activity (Joint Stock Company).

Subsequent regulations allowed for 'economic practice activity' and the establishment of private banks. Since 1992, when the privatisation law was issued, the sale of state property by the Libyan government was permitted. Many sources point to Act no. 5 of 1997 that encouraged foreign investment in Libya, which is a landmark event defining the conditions for foreigners investing in Libya (Aljbiri, 2008).

On 1st January 1998, the Libyan government made several agreements for foreign trade. One of them is the free Arab market, which started to repeal customs fees on Arab commodities, with the expectation that there would be free movement of trade among the countries that signed this treaty within the decade. After that, Libya started to exempt Arab commodities from all customs fees and tax, and officially submitted an application in 2001 to join the World Trade Organisation (WTO) (Masoud, 2009).

The membership of the WTO assures the access of Libyan manufactured products to the world market, and entrance of the foreign products to the Libyan market, that will put Libyan production in competition with foreign products in the Libyan market including intellectual property rights and institutions to promote the trade and investment. The aim of this opening policy is to increase the efficiency of foreign production facilities and to create competition within the Libyan market.

By 1999, more considerable changes in the economy started to occur, specifically in the banking sector. The most important step was the adoption of the BPC resolution No. (1) In 1999 concerning banking law and credit currency. However, the trade

economy organisation issued laws in this regard. Then, in 2003 the Libyan President, Colonel Al-Qaddafi explained that the socialist experiment is a failure and called for the privatisation of the public sector including the oil industry and the banking sector. He also invited the application of the alternative social capitalism, a form of corporate owned by Libyan citizens. This new policy opened the door to utilising foreign expertise in order to liberate the Libyan economy.

In September 2005, Al-Qaddafi asked the people, “With the exception of oil, show me what are the other goods produced by Libyans that can draw money to the country?” He further stated, “We have considered how to raise the income of Libyan citizens, for which we have to engage in trade. We have to produce and make a profit.” However, in his conclusion, it is clear that the regime stability was threatened (Altunisik, 1996). Consequently, the economic reform programme was associated with political policy reform.

#### **2.2.1.7 The Results of Economic Reform Program**

As already indicated, the challenges mentioned are only beginning to be addressed. For example, the pace of economic and structural reform upgraded when the UN and USA trade sanctions were lifted. At the same time, the rates of other developing countries have improved with an average annual growth rate of real GDP around 0.3 percent since 1999, that means in 2007 the real Libyan GDP in constant prices turned about 5.5 percent times greater than that was in 1999. Libyan real GDP per-capita also rose by 4.7 percent during this period. At the same time, the increasing growth of the national economy showed that the exports of oil were accompanying domestic product. In 1999 total exports was less than LYD 36,822 million. Reform results include the passing regulations to encourage private, domestic and foreign investment, and the abolition of customs duty exemptions enjoyed by a public corporate aided by the reduction of customs duties. Libyan exports improve at an average annual growth rate of 13 percent, a large portion of which came from primary products of manufacturing. At 2004, total Libyan exports had reached over LYD 208,483 million while imports during the same period grew almost at the same rate. On average, it increased from LYD 19,286 million in 1999 to LYD 82,552 million in 2004 in real volume terms that put Libya for thorough involvement in the global economy opening

its doors to the outside world, especially to European countries. This renders the Libyan economic policy more relatively significant in the international economic framework (CBL annual reports).

### 2.2.2 Challenges and Opportunities

The Libyan economy suffers from many negative aspects resulting from the political situation and financial crisis. As mentioned earlier, different obstacles were imposed on Libya by the (US) and the (UN). The challenges were as follows:

In 1981 United States US prevented Libya from exports of crude oil in 1981 and extended it later to include direct trade, commercial contracts and travel activities. Moreover, in 1992 the United Nation (UN) approves Libyan economy that influenced severely. These prohibitions have impacted over health, education, oil sector and other sides of Libyan people's lives negatively. This circumstance went to be feeble the Libyan economy. This embargo came after the accusation of two Libyan citizens of involvement in the crash of an American aeroplane in Scotland in 1988. The embargo was eased in 1999 and completely withdrawn.

In 2003 after the country accepted responsibility for the crash, whereas the (US) embargo ended in 2004. Furthermore, in June 2003, President Al-Qaddafi declared that the country's public sector had failed to lead the economy in Libya and so called for oil sector privatisation, pledging to take Libya into the World Trade Organisation (WTO). Since August 2003, United kingdom (UK) and United States (US) have agreed that Libya will accept the responsibility for the 1988 bombing of Pan Am flight 103, whereupon Libya agreed to pay USD 2.7 billion as a compensation to the victims' families of the Lockerbie (Scotland) air crash. As a result, the (UN) Security Council voted on 12th September in 2003 to withdraw its 11 year economic sanctions regime and the arms embargo to Libya for 18 years.

On 19th December 2003, the Libyan Foreign Minister declared that, the government decided to get rid of the internationally banned weapons (Paul, 2004). In 2004, Libya agreed to pay compensation to the French airline UTA for the loss of a plane that crashed over the West African state of Niger in 1989. Libya also agreed to pay USD

170 million compensation, USD one million for each of the victims' families, and to pay USD 35 million to the victims' relatives of the attack that made on a discotheque in West Berlin in 1986 (Tim, 2004). After that, on 23rd April 2004, (US) President Bush made the decision to remove the remaining sanctions on connected business in Libya, by sending a diplomatic mission to work in Tripoli. Six months later he revoked the trade embargo on Libya, but Libya was still on the state sponsors list of terrorism.

By 27th April, Al-Qaddafi visited Europe after 15 years of the Euro-Mediterranean Partnership (EMP or Barcelona Process) for preliminary talks, with an announcement in Brussels that he would again support Freedom Fighters if the West refused his offer of peace (Tim, 2004 and Fernandez & Rainey, 2006). Then, on 23rd May 2005, Human Rights Watch, during their first visit to Libya reported that, the country had taken significant steps to improve the human rights record. However, there were still serious problems, including the use of violence against detainees, restrictions on the expression and society, and the continued detention of political prisoners. Based on these challenges, some opportunities came out as follows:

In October 2003 list of 360 corporates in various sectors (steel, petrochemicals, cement and agriculture) went to be privatised (Energy, Information Administration/Department of Energy, 2005), announced by the Prime Minister that reached three steps. In the first step, the proprietorship of 26 factories was shifted from the public to the private sector by the end of 2005. The second stage was to transfer 46 factories into shareholding companies in which employees and others would own shares by the end of 2007. The third stage aimed at privatising 54 factories during the period 2007/2008.

After the year of 2003, Libya observed more development in its connection to the west, that facilitated further emphasis on venturing investment in the oil and gas sector where competition rivalry was enhancing between (EU) and (US) companies. With a target of investment of some USD 30 billion by 2010, the National Oil Company (NOC) launched more series and attempts of assessment and Production Sharing Agreements, which included incentives for both oil and gas development companies (Zouber & Amirah-Fernandez, 2008). Additionally, Libya is also searching for the

internal political modification according to the fact that it cannot integrate a foreign policy, exposing to the international capitalist system with domestic political system based on post-Cold War revolutionist.

Since September 2004, when the (UN) and (US) put Libya under the specific trade sanctions, the measures for improving the private sector role in the economy were undertaken, accelerated the reform in Libya (IMF, 2005). Furthermore, on 1st November 2004 to achieve the liberalisation of the economy target, Prime Minister Shukri Ghanem announced that Libya would eliminate some worthy subsidies on electricity, fuel and essential food items worth USD 5 billion. After one month of withdrawal of the freezing of USD one billion from Libyan assets in US banks, this was done successfully.

In the middle of November 2004, President Bush asked Congress to increase the US ban on American export and imports bank loans to Libya. This step had paved the path to facilitate US investment (Zouber & Amirah-Fernandez, 2008). Moreover, in January 2005, according to the declaration of the Libyan government the first tender of the entire series for Exploration and the Sharing Agreements of Production (EPSA) and 11 of 15 new EPSA to American oil companies operating in partnership with other firms had been facilitated. Petrobras of Brazil, Indian oil, the Medco Energy International of Indonesia, Oil Search of Australia, Vertex Energy of Canada, and Sonatrach of Algeria are the countries which benefited from Libyan oil and gas that reflected global interest upon Libyan hydrocarbon deposits (St John, 2014). On the other hand, Italian businesses, particularly investment companies which provided about 25 percent of Italy's total energy imports had interests in the Libyan oil and gas. With the activation of the "Green Stream" gas pipeline, its share was increased to 30 percent.

On 3rd February 2005, the US Boeing Corporation announced the sale of up to six 737-800S to Buraq Airlines, the first private Libyan airline company for the cost of about USD 367 million (St John, 2014). In March 2005, to establish branches in Libya and contribute as shareholders in local banks the General People's Congress (GPC) approved a procedure allowing foreign banks.

In August 2005, for encouraging the trade and making the country free trade area, thereby Libya collected import taxes (except for those on cigarettes). These duties supplanted by a 4 percent tax named the Service Import Tax. Sarah Whitson, who works as a MENA director at Human Rights Watch, said “The Libyan Government’s invitation reflected a welcome degree of transparency. We are looking forward to further human rights improvements in the country, as Libyan and international laws demand” (Human Rights Watch, 2005).

In May 2006, the US returned full diplomatic relations with Libya, and removed it from the State Sponsors of Terrorism list. In addition, the country also omitted Libya from the annual certification of countries that are not fully cooperating with American antiterrorism efforts.

In October 2007, eventually Libya was voted in the UNs Security Council as a non-permanent member. Although Washington did not endorse the Libya’s application, it did not block it either (as was done in previous attempts to join in 1995 and 2000) (Kaplan, 2007). After that, in December 2007, French President Sarkozy was the first Western leader after 2004, who welcomed Col. Qaddafi to his country. Col. Qaddafi decided to rebuild diplomatic relations for ending the country’s isolation from the US and Europe. The two parties (Libya and France) signed number of business agreements, such as accord to supply of several nuclear reactors to desalinate sea water, and develop the peaceful use of nuclear energy. They also signed deals worth ten billion Euro for French firms (BBC News, 2007).

After Qaddafi had made this five-day trip to France and made these deals, he also visited Spain (his second official visit since 1984), where he met with Prime Minister Zapatero and King Juan Carlos. He also made some investment agreements with some Spanish firms located in Libya worth over USD 17 billion (€11.8 billion). In addition, there was a possibility of 2 billion € investment in defence and aeronautics and over USD 5 billion in the Libyan energy sector. Other investment enterprises with the Libyan government are anticipated for infrastructure contracts worth in excess of € 50 billion in Libya. At the end of this visit, Libya and Spain signed a political cooperation accord which says the Spanish will help train the Libyan police in migration and border control.

On 5th September 2008, the (US) and Libya relationship entered an historic new phase when Condoleezza Rice, the (US) Secretary of State visited Libya for the first time after 1953. She pointed out that America had a long and bad history with Libya, which started to improve when they turned away from nuclear weapons and terrorism. She stressed that although the relationship between the two countries has developed, they have a long way to go. Hence, they are working on a trade investment framework which would improve the climate of investment as demanded by many American firms (Shernannah, 2013).

Hence, the Libyan economy became open in front of flourishing business and investment after a long period of isolation and suffering. This country demonstrates to hold the largest oil reserves in Africa, accounting for greater than 3 percent of the world's total reserves. These facts and events are unswerving with the Libyan geography and natural resources (oil and gas), and helped the country to take a step further in economic relations with most other countries, even after being positioned in the heart of the North African region. Libya has a very small population reached 6.089 million in 2007 with a huge land of about 1,759,540 sq. km where most part is still in a natural undeveloped state. Libya started to focus on one of the most important issues on the agenda for government policy, the economic reform and Libya's reintegration into the international community after solving all its problems.

The Libyan government regarded that this step would expose an access for a Unionpan-African body. Libya is a founder member of the 50-state African Union Organisation, which retains ties, political and economic relation to its members and is a leading participant in the organisational activities.

In brief, it can be seen that after the withdrawal of United Nation's sanctions in 1999, the oil and gas field of Libya had opened to international investors. This situation led to increase Libyan income from oil and gas exports, which encouraged the government to introduce a series of liberalisation economy measures, including a significant role for deregulation and private sector ownership. As a result, Libya's economic growth rate turned one of the highest average in the world during that economic reform period. GDP went up to reach an average rate of 22.6 percent annually. Moreover, gross fixed investment had reached an average rate of 15.6

percent per annum, with a share of non-oil GDP reaching 63 percent (CBL 51st annual report, 2007). Thus, within these financial and political changes in Libyan history, the economy began to change from a socialist command economy to a Western-style free market system. In this system; the citizens were increasingly expected to fend for themselves.

It is understandable that the newly-established stock market had expectations placed upon it to create a welfare and growth in the national economy. Even though, the political history of Libya is somewhat dissimilar from other developing countries. At that time, Libyan government realized that there are certain influences that are peculiar to Libya, and consequently they require early evaluation of the stock market performance. As a result of that, Libya has launched an economic reform programme as an attractive development option to help sustain the national economy and financial investment. This step sets the preliminary stage to serious decision for Libyan Stock Market establishment<sup>2</sup>.

### 2.3 FINANCIAL MARKET

Financial market plays a significant role between lenders and borrowers, without financial markets, borrowers would not find the lenders quickly. Intermediaries, such as banks are quite similar to these markets; they take deposits from those who have money to save and can lend money from this deposited money to those who need to borrow as loans and mortgages. However, transactions in the financial market are more complex than a simple bank transaction. It requires market where borrowers and their agents can find lenders and their agents, and where lending commitments can be sold to other parties too. A good example of financial market is a stock exchange where a company can earn money by selling its shares to the investors, and its current shares that bought or sold as well.

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<sup>2</sup> For more information about Libyan economy, see Masoud. N (2009).

In her study Rose (1997) reported that the financial market is a saving channel to those individuals and institutions that need more funds for spending than are provided by their current income. She considered the financial market as a heart of the financial system attracting and allocating savings and setting interest rates at security prices. In addition, Mishkin & Eakins (2006) described the financial market as a place where people can become rich or poor quickly and where offer the money for its demand (investors). The financial market helps to transfer a good part of basic savings of the society to a profitable investment. It also helps to produce capital that is the most important factor of production. According to this concept, this market is defined as a collection of links between the surplus units' savers (individual or institutions) and deficit units. This meeting between the two parts exists in an organized system. In addition, some authors defined the financial market as a base of exchanging the shares and bonds and making deals in a limited time, based on the market the regulations and rules. From all these definitions a comprehensive definition can be deducted as follows:

1. Financial markets are the organizations that facilitate the trade in financial products and stock exchanges by facilitating the trade in stocks, bonds and warrants.
2. A financial market is a meeting between buyers and sellers to trade financial products that are stocks and shares between them in some ways, including the direct use of the stock exchange between buyers and sellers.

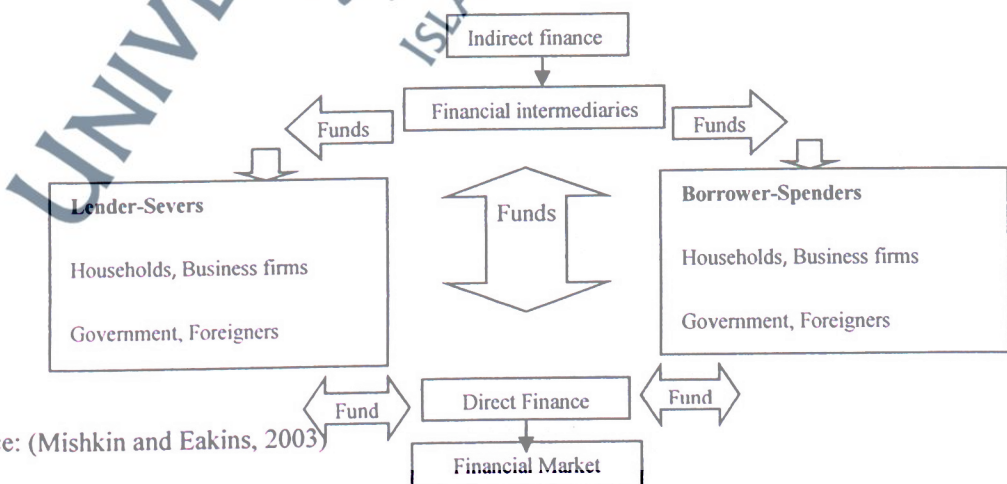
### **2.3.1 The Function of Financial Market in the Economy**

Stock markets and their economic functions represent a strong linkage among the various sectors in society, including savers and producers considering that the saving sector needs to employ their savings in more beneficial projects. In addition, the productive sectors always need financial sources to help them in continuing to perform more economic functions (Masoud, 2009). Besides, the financial system performs doing the essential economic function of funding from the savers (whom are their expenditure less than their income) to the spenders (whom they wish to spend more than their income). The most important lenders are resident citizens. However, firms, the government and foreigners may also lend their excess funds. Conversely,

the borrowers are usually the firms and the government, sometimes resident and non-resident citizens as well. Funds flow from lenders to borrowers in two ways. Firstly, indirect or market-based finance (top of a chart) debtors borrow funds directly from lenders in the financial market through selling the financial instruments to them (such as stocks and shares) which are claims on the future income of the borrowers. Secondly, if financial intermediaries play an additional role in the funds' channelling, it indicates to indirect finance (bottom of a chart). These financial intermediaries are classified into credit institutions, monetary financial institutions and other financial intermediaries. Financial market and financial intermediaries are not separate entities, but they have a strong relationship (Aljbiri, 2008). In her study, Levine (1997) reported that in a modern economy, the financial system has four essential functions as follows:

1. The financial system provides a suitable environment of low-risk outlet for the public's savings.
2. Financial systems also provide tools of store purchasing power until needed for future spending on goods and services.
3. The financial markets provide tools to protect businesses, consumers, and government against risks to people, property and income.
4. These systems provide channels for government policy to achieve society's targets of high employment, low inflation and sustainable economic growth. Figure 2.1 shows the flow of funds via the financial market.

Figure 2.1: The Flow of Funds Via the Financial Market



Source: (Mishkin and Eakins, 2003)

## 2.4 STOCK MARKET

The stock market is the main gateway to draw the savings into the productive sectors and the national economic interest. The market is adding well to complete the privatization and expansion of proprietorship based business. Finally, it may lead to the development and the betterment of the economic growth by encouraging the investment channels that will affect the economic growth positively. A very few researches have been found about the LSM activities because it has become a developed market. Accordingly, it would be useful to add some relevant information about it to the available literature in the respective field.

### 2.4.1 Definition of Stock Market

The stock market is a very advanced market place, where equities and shares are the traded commodity. At the same time, it is a necessary issue for the creation and development of a strong and competitive economy. It is also a key to structural transformations in any economy; from the traditional, rigid, insecure bank-based situation to a more flexible, more secure economy that is safe from the shocks, fluctuations and lack of investors' confidence. Stapley (1986) and Heertje (2004) indicated that stock markets are places where government and industry can increase long-term capital and where investors can buy and sell securities. Normal markets are simply considered as mechanisms to allow the possibility of trade among individuals or institutions. While some markets (e.g. for livestock) are physical where buyers and vendors meet to trade, whilst others (e.g. for foreign currency) are a national network based on communication using telephone lines and computer links with no physical meeting place.

Additionally, very few stock markets around the world still have a physical location where buyers and sellers meet to trade. Wai & Patrick (1973) argued that stock markets are those markets which have been treated with money, in the short and long-term. Here the firms sell stocks in order to generate long-term capital that will channel into their profitable options, because people would invest in winners rather than losers; buyers hold on to their stocks for future dividend payouts. The activities of buying and selling equities in the stock market are significant for the distribution of

capital within economies (Pratten, 1993). Moreover, transaction prices provide investors with indicate the market value of their wealth that may effect on their decisions about their consumption expenditure (Pratten, 1993).

Despite prices are alarmingly high or rising, this indicates a rise of confidence among investors, and affects the confidence of businessmen and then their investment. Furthermore, the stock exchange is the main factor of the decisions of the business investment. The reason is the price of shares affects the quantity of funds that increase by selling newly issued stock to fund the investment expenditure.

According to Teweles & Bradley (1998), in North American culture the word ‘stock’ means ownership or equity. In companies, these stocks are traded in the market called the ‘stock exchange. Besides, Fabozzi et al., (2002) offered three types of stock market role. Firstly, the interactions of buyers and vendors in a stock market which determine the value of the traded asset; secondly, stock markets provide a mechanism for investors sell a stock and asset; thirdly, it reduces the cost of the transaction.

On the other hand, Mishkin & Eakins (2006) defined the stock market as a safety that denote on a share of ownership of the earnings and assets of the firm (shares of stock). Stock markets also classify as debt and short-term debt tools (money market) and longer-maturity financial assets (capital markets), including cash or spot and futures markets as displayed in Figure 2.3.

#### 2.4.2 Money Market

Historically, the money market has been a highly active location where many buyers and sellers enter it with different offers daily. It considered based on a 365-day year in the (UK) and on a 360 day year in the (US) (Mishkin & Eakins, 2006). Starting from 1970 it has become more important to increase the interest rates sharply. These rates tend to be very fluctuating. During the period of (1970s - 1980s), the rates increased in the short-term that came with a regulated ceiling on the rate that banks could pay for deposits, led to a rapid outflow of funds from financial institutions. This outflow, in turn, caused the failure of many banks, savings and loans. However, the word “money market” in fact refers to the markets for financial tools where trade the short- term

investment securities of less than one year. It gives a chance to the borrowers to get short-term loans.

It also gives the opportunity to the investors to get a high level of security by investing their money in financial assets with a high level of liquidity since the commercial banks play a significant role in this market's activity. Money market security has three main characteristics. Firstly, it usually has a sale in large denominations. Secondly, it has lower default risk. Thirdly, it matures in one year, while the instruments of the financial mature in less than 120 days. The money market is a market for short-term treasury securities, especially treasury bills, having 91day, 182 days, or 12 month maturity which widely holds liquid commercial securities, federal-funds, and re-purchase agreements. Besides, this market includes the bank's 6-month certificates of deposit and the banker's acceptances. The most important advantages of the money market are high flexibility, low risk in terms of money and credit risk. These also decline the cost of transactions to develop secondary markets that have a place for corporates or financial institutions' warehouse surplus funds for short periods until they require them.

### 2.4.3 Capital Market

The word "capital" refers to markets for financial means of long-term investment instruments with entitlements of one year or more where trade the equity tools. Capital market securities hold by financial intermediaries, insurance companies and pension funds. These have a little believable amount of funds that will be available to deal with in the future. The most significant instruments of this market's shares and bonds in the long-term debt are:

1. Capital market related with long-term securities.
2. An effective role in financing the long-term productive projects.
3. A capital market more organized than other markets because of associated dealers and specialists.
4. Invest in the capital market is less liquid and riskier than the money market. The returns are high on capital compared to the investment in other markets.

In this market, the returns are high compared with the other markets. The capital market is divided based on the facts whether the financial tools contain a promised output of cash flow during the time, or offer participation in the firm's future profitability. The following sections will describe the classified markets briefly.

#### **2.4.3.1 Cash and Spot Market**

This market deals directly with buyers and sellers, and it contains two parts: primary market and secondary market. The next portions will discuss these two types as follow:

##### **1. Primary Market**

The primary market, also known as "issue market," issues security stocks, bonds, shares, including the businesses that allowed to issue the securities. Jones (2007) argued that primary markets are completely vital to capitalist economies. They are a source for the owners to the finance productive activities users, because they serve to channel funds from savers to borrowers. These businesses could challenge an initial public offering on their own, and thereby depend on the assistance of investment banks. The latter represents institutions which specialise in marketing initial ownership shares, offered by the new business activity that provides shares in the primary market at a slightly higher price.

##### **2. Secondary Market**

This type of market is where the sale of the securities is previously issued, because most investors have plans to sell long-term bonds before they reach maturity. In the end, they tend to sell their holdings of stock to brokers and intermediaries. In fact, in secondary market brokers specialised developed a superior knowledge of the factors which influence risk, costs and returns relating to exchanging financial instruments in these markets.

As already indicated, secondary markets are very important contributors to the efficient performance of primary markets, because the former has the ability to purchase or sell previously issued financial tools. This factor makes these tools much

more flexible than other markets for their investment. It also enables them to move quickly without a big loss in market value, from one security to another and from security to cash (Haugen, 2001). There are two types of market in the secondary market for capital securities: organized market and unorganized market.

### **i. Organized Market**

Organized market has a building for buying and selling securities (including stocks, bonds, options, and futures). This market performs trading with specific procedures for instruments of securities, which are recorded according to the rules and regulations to ensure that they will lead to the competitive trading.

In his study Haugen (2001) reported that there are major organized stock markets worldwide. For example, the Nikkei in Tokyo is one of the pioneer active markets internationally. Another major market is the New York Stock Exchange (NYSE), in which trading the shares of around 1,600 firms. The second largest stock exchange is the American Stock Exchange (AME) which includes the London Stock Exchange (LSE) in the UK, the (DAX) in Germany and the Toronto Stock Exchange (TSE) in Canada. Organized market divided into two types as follows

#### **a. Third Market**

This market involves the trading of listed securities in the OTC market. The market is unorganized and includes brokerage firms which are not members of the organization, although they have the right to deal in securities registered in those markets. Moreover, these brokerages are willing to purchase and sell securities at a greater or lesser amount.

#### **b. Fourth Market**

The fourth market indicates direct trade among institutions without using an exchange. This market includes the trade between major institutions and rich individuals, who deal with buying and selling securities in large orders. This task is performed as a strategy to decrease the commission paid to brokers through a strong network of

telephones and computers. Thus, the conclusion of four transactions can occur in the market quite rapidly at low cost.

Libya solely has an organised stock market. There is no definition of the fixed commissions for the transactions dealt in the Libyan stock market, where there is no condition to create a third or fourth stock market as in the US. According to the Libyan Stock Market Authority (LSMA) rules, it is not allowed for any brokerage firm to operate in the stock market without registration. A brokerage firm requires a license from the LSM that allows it to work as a financial intermediary.

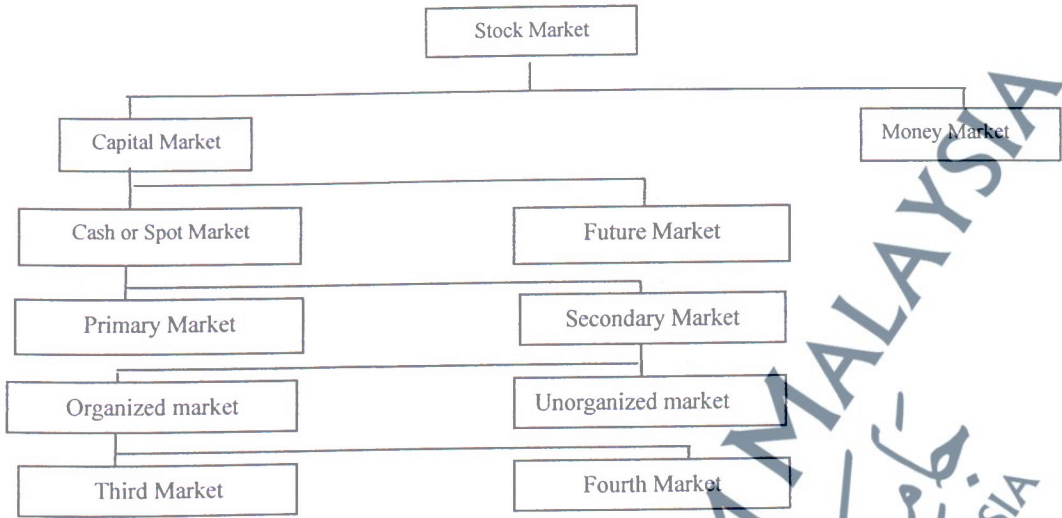
## ii. Unorganized Market

This market also named as the Over-The-Counter (OTC) market, and it does not have a site where trading the unlisted stock. In this market, trading operations are done by using a nationwide network of phone lines and computer links that determine the prices by financial paper negotiations. Haugen (2001) said that there are two levels of prices (wholesale and retail). Retail prices are offered to individual investors who are usually executed orders through brokers. Conversely, wholesale prices are offered to other dealers who wish to alter their inventory positions. Henry (2000) has noticed there are two more markets present in the US named: Third and Fourth market.

### 2.4.3.2 Futures Market

In his study Cuthbertson & Nitzsche (2001) argued that forward and future(s) contracts treats in a similar way. Usually, forward contracts involve no upfront payment and cash, but are hand covered only at the expiry of the contract that negotiated between two parties and usually is not significant. A future(s) contract trades in the market and involves a down payment known as the initial margin. That is a deposit to ensure both parties to the contract are active, which usually earns a competitive interest rate without cost. Typically, a futures contract is a forward agreement that is updated on the market to market on a daily basis. Figure 2.2 shows the classification of stock markets.

Figure 2.2: Classification of Stock Markets



Source: (Handay, 1997)

#### 2.4.4 The Importance of Stock Markets

Stock markets contribute immensely to the economic development all over the world. Theorists and researchers gave different opinions and argued over the importance of stock markets in increasing economic development in recent years. They addressed that stock markets have the activities like attracting and enhancing savings and other forms of capital, which is imperative of both the private and trade sectors, which will improve the stock market's role in commerce, information technology, communication and management. Singh (1998) emphasized on the fact that there are three critical elements of a stock market which can promote economic growth:

1. Increasing savings and investments.
2. Improving the productivity of investments.
3. Raising the profitability of existing capital stock.

Furthermore, there are many factors that have helped stock markets to gain prominence during the 1990's in many countries. These factors include an increase in the private sector's role in the different types of economic activities, innovative technological advances and the strong speed of getting the financial information. In addition to that, there have been advances in communication means through the

appearance of new and useful financial tools. Besides new legislation was introduced which guarantees freedom of trade and movement of capital. All of these indicate the importance of stock markets in providing more opportunities for growth.

#### 2.4.5 Market Size

The stock market size determines through the usage the volume of capital and listed companies, and it proxied by the number of listed companies. The rationale for this measure is that most of the stock market size positive correlates with the ability to capitalize mobilization and diversify risk on the economy all over the world. Demircuc-Kunt. A & Levine (1996); Hartmann & Khambata (1993) and Subrahmanyam & Titman (1999) have calculated market size as an indicator for stock market development. According to their calculation, it consists of two elements. Total market capitalisation is measured by the total listed shares value on the stock market. The listed companies' number in the stock market can indicate to the extension of the value increasable between the listed companies. In addition to these two dimensions, market capitalisation per GDP can be considered as an indicator of market size. Bekaert. G. et al., (1995) addressed that the ratio of equity capitalisation to GDP is a useful tool in describing the time-series of market integration. Morck et al., (2000) determined that the larger market size relative to economic activity contains more informative prices. These would help the investors and managers to differentiate between sounds or poor investments through more precise proxies of stocks.

##### 2.4.5.1 Market Capitalization

As a proxy of stock market size, a standard index often used that is the market capitalization. This measure is equal all listed shares' total value. In terms of economic importance, the assumption comes through market size and the ability to mobilize capital and diversify risk is positively correlated (Alajekwu & Achugbu, 2012).

In their study, Beck & Levine (2004) addressed that with market capitalization, there is no theory that indicates that shares listing will effect on resource allocation and economic growth. Levine & Zerovs (1998) indicated that market capitalization is not a

good predictor of economic growth. Meanwhile, Yartey (2008) has a different opinion about this issue, he assumed that behind this measure is that overall market size is has a positive correlation with the ability to capitalize mobilization and diversify risk on an economy-wide basis.

#### 2.4.6 Market Liquidity

Liquidity indicates to the possibility of turning the securities into cash through an efficient market system, or more precisely, the ability to easily buy and sell shares.

In his study, Demirguc-Kunt & Maksimovic (1998) specified two main reasons behind the significance of liquidity in the stock market description. The first one is that liquidity relates to the probability of risk of the investment. An investment is deemed to be less risky where investors are able to adjust their portfolios quickly with cheap cost. Meanwhile, the second reason is the capital allocation is more efficient and as such liquid market enhances long-term economic growth.

Moreover, Aljabiri (2005) addressed another point, which says that stock market liquidity produces a profitable interaction between the stock market and the money market. This communication helps the shares to become readily acceptable as collateral for bank lending, thereby increase the credit and investment. There are two main proxies of liquidity, turnover ratio and total value traded ratio.

##### 2.4.6.1 Turnover Ratio

Liquidity is the speed of which the economic agents can buy and sell securities. With a liquid market, the initial investors can get their savings during the investment project because they can quickly, cheaply, and easily sell their stake in the company. So, ease of investment in the long-term can come from more a liquid market, probably more profitable projects, thereby improving the capital allocation and improving prospects for long-term growth. This ratio measures the market liquidity, which is considered as the total value of shares traded divided by the total value of listed shares or market capitalization (Adenuge, 2010). Beck & Levine (2004) preferred this measurement rather than the other measurements because contrasting with other measures, the numerator and denominator of turnover ratio contain prices.

### 2.4.7 Market Index

The stock market index reflects the change in the market capitalization of the securities by listing and including the calculation of the index. The index calculation depends primarily on the momentary transitory closing prices for the instantaneous papers included in the equation of the index as well as these are affected by the relative weight of the index equation papers. From that ground, any change in the closing price of one paper will effect on the whole index by depending the relative importance of this paper in the index (LSM publication).

### 2.4.8 Market Efficiency

In his study Maalkiel (2003) introduced the definition of efficient financial markets. He states that efficient financial markets are the markets that prevent the investors to earn above-average returns and arbitrage opportunities without accepting above-average risk. The author also reported that some unusual behaviour of stock prices can produce portfolio trading opportunities which give the investors a chance to earn the exceptional risk amendment return. This situation suggests that stock markets are still efficient even if some interruption or obstructions happened to them. Furthermore, the same study criticized some studies which found that, for the reaction against new information or important news announcement, with the time, stock prices will illustrate the positive serial correlation found by investors. He shows that the evidence of efficiency happening by specific system in the stock market is often rather thin (Fama & French, 1988, 1998).

Malkiel & Fama (1970) for USA; Dryden (1970) for the UK; Solnik (1973) for eight European markets; Conrad & Juttner (1973) for Germany; Jennergren & Korsvold (1975) for Norway and Sweden and Aybar (1992) for Turkey tested the weak form efficiency hypothesis. These studies found mixed results. Butler & Malaihah (1992) investigate the behaviour of individual returns in two stock markets, Saudi Arabia and Kuwait, during 1985-1989. The authors used serial correlation several tests to evaluate the weak form efficiency in the two stock markets. Their study tried to examine the similarities and differences of these stocks, regarding exchange mechanisms and efficiency. Their findings were that institutional factors help the operational

inefficiency in the Saudi Arabia stock market, including trading delay, liquidity, market fragmentation and the absence of official markets.

Some studies for Arab markets were provided by Gandhi et al., (1980) and Fram & Ajami (1994) found the same results. Especially Fram & Ajami (1994) examined the efficiency of four Gulf States' markets, which are Kuwait, Saudi Arabia, Oman and Bahrain. He used a serial correlation test and a runs test, Al Ajami reported that his study results provide evidence to substantiate the claim that a small stock market does not conform to the efficient market hypothesis. The efficient market theory is not strongly supported even in more developed markets. Dryden (1970) investigates the changes in price of 15 stocks listed on the LSE, the results of some statistical tests agree with the random walk model, despite small systematic changes which mention that perhaps there are some patterns present in share prices.

Based on Malkiel & Fama (1970) the hypothesis was derived called Efficient Market Hypothesis EMH. Age & Kocaman (2008) studied the emerging capital markets and the efficient market hypothesis and as empirical evidence from the Istanbul Stock Market. They depicted that there are three types of stock market efficiency as follows:

1. **Weak Form:** This type of market focuses on the information subject of historical price or return consequences. It means weak form efficiency asserts that the stock price reflects all historical data, in particular historical rates of return.
2. **Semi Strong Form:** Based on this form, all public information, like accounting data and annual reports of listed companies are earning announcement and dividend increase announcement, are available for the investors, because that will reflect in the prices of the stock market.
3. **Strong Form:** This focuses on the fact that the current price of the market reflects all public and private information (including inside information).

#### 2.4.9 Market Activity

Stock market activity is defined by two selected factors: the value and volume of trade divided by GDP and the turnover ratio with the number of transactions. Levine (1991) and Bencivenga et al., (1995) (1996) stated that there is a linkage between higher

transaction costs and lower value-traded ratios which may affect saving rates to economic growth rates. Using cross-country regressions during the period (1976-1993), Levine (1998) said that stock markets might improve growth through liquidity. They found that stock market activity had a positive correlation with measures of real activity. Atje & Jovanovic (1993) used a similar approach for forty countries during the period (1980-1988). They explored significant correlation between the value of stock market trading as a percent of GDP and economic growth. Petersen & Fialkowski (1994) and Datar et al., (1998) provide further illustration which stating that the quoted spread is a poor proxy for actual transaction costs faced by investors. They called for an alternative measure such as turnover rate that may perform a better job of capturing an asset liquidity. Brennan et al., (1998) and Chordia et al., (2001) found a negative and significant linkage between expected returns and the level of liquidity substituted by trading volume and share turnover ratio.

#### 2.4.10 Market Volatility

An average of 12 months' records may guide and could even provide concrete ways to understand the issues involved. Different authors focused on the empirical evidence upon stock market liberalisation and volatility, such as the work of De Santis (1997); Aggarwal et al., (1999); Yang & Huang (1999); Han Kim & Singal (2000); Kassimatis (2002); Bekaert & Harvey (2003a, b) and Bekaert et al., (2005).

Therefore, stock market volatility can reflect changes in money supply and oil prices (Engle & Manganelli, 2004). A detailed empirical analysis of the main determinants of stock market volatility and how they responded significantly to the volatility of the exchange rate in Canada has been shown by (Koutoulas & Kryzanowski, 1996). Kearney (1998) who found the similar results in Ireland. Meanwhile, (Fang, 2000) explored a negative reduction effect in the stock market return process related to the Asian crisis in Taiwan. Many studies have found a lower volatility in developed markets than in emerging markets. For example, it is obtained from the study of Ferson & Harvey (1994) which emerging markets have higher volatility than their industry or developed markets. Also, Stone (1992); Divecha et al., (1992); Wilcox (1992) and Harvey (1994), (1995) documented high volatility in emerging market.

Low correlation between developed and developing markets reduces volatilities in portfolios from these markets (Hassan et al., 2006).

## 2.5 LIBYAN STOCK MARKET

Libyan government recently realized that the country is in urgent need to create a market for securities for the changes in the economic arena of local and international markets. The stock market is one of the effective means to mobilise savings and turn them into investments in all productive sectors of the national economy. The stock market is also necessary because of the results of the experience of ownership earlier in the absence of an integrated system for the stock market. The consequent problems include the low efficiency of the performance of the public companies. In addition to the apparent weakness in demand for the Initial Public Offering (IPO) in the shares of the companies that offered for privatization. The establishment of a stock market is not just a simulation of the experiences of other countries in the same area, but a necessity imposed by the critical situation faced by Libya currently.

In his study Aljbiri (2012) said that:

“Recently, in Libya many economists and financial authorities and also many studies which done recently have recognized that the establishment of capital markets is necessary for improving medium and long term financial intermediation, enhancing savings mobilization, augmenting financial sector competition, facilitating the conduct of monetary policy through indirect instrument, and attracting much needed foreign capital”.

### 2.5.1 The Establishment of Libyan Stock Market

The Libyan stock market LSM is an emerging market, it established in June 2006. Accordingly, the General Peoples' Committee issued Resolution No. 105 of 2005 which states that the mission of the Libyan Stock Market establishment is to be assigned to the General Peoples' Committee for the Economy. It shall make all the necessary arrangements to oversee the establishment process and develop the market in order to contribute to investment development. This decision was based on Law No. (21) Issued in 2001 on engaging in economic activities, as article 10 of this Law states that the General Peoples' Committee has the right to determine who is

responsible for the process of establishing a stock market in Libya. In March 2006, the General Peoples' Committee issued Resolution No. (134) on the establishment of the Libyan Stock Market, with the capital of 20 LYD million. According to that, the General Peoples' Committee on the Economy issued Resolution No. (244) of 2006 on the nomination of the first General Director and the first management committee of the Libyan Stock Market, in Tripoli and Benghazi branches. During that period, only six companies were listed, and manually trading operations. In 2008, due to increased trading volumes and to ensure the safety of transactions in the market, the market administration launched the electronic system for trading, clearing, depository and central registry.

In 2008, the General Peoples' Committee issued Resolution No. (436) as a new statute of the LSM transferring the market to the Economic and Social Development Fund (ESDF) and increasing its capital to LYD 50 million. At the end of 2008, the Libyan Stock Market issued rules and regulations governing the operation of the stock market which are supposed to serve the investors and ensure the integrity of the market transactions. Then, the market shares were offered to the public and private sectors to become a joint stock company owned by a number of legal entities and more than 1,400 shareholders on 16th January 2008.

### **2.5.2 Libyan Stock Market (LSM) Development**

The Libyan Stock market has gradually experienced development over the past years and has led to increase in investment channels and economic growth. Hence, it is one of the fundamental pillars of the Libyan economy. It gives an opportunity to the savers to invest their money and savings in the form of securities and achieve great returns leading to increase of the GDP. The increasing of the investment opportunities afforded by the markets may lead to attracting many investors, including the local and foreign investors.

In the establishment year, LSM was still new (in the infantile stage); the number of contributing companies and the trading volume was very small, and there were no public and foreign investors in the market. The total trading volume in the stock market was only LYD 355,840 (LSM annual report, 2006).

In 2007, the LSM stayed in the same situation. The average of trading was very small, the variations were very small as well and the contributing companies were very few.

The situation was at this level until 03/04/2008 when the electronic trading was started that made the market's transactions more efficient (high in speed); which in turn increased the number of contributing companies, was because the market made invitations to the private companies to become contributing companies in the market, to contribute and improve the stock market development in Libya.

Through 186 meetings traded for this year (2008), the number of trading was 4,385,228 shares totalling LYD 427,782,296.600, "Four hundred and twenty-seven million seven hundred and eighty-two thousand and two hundred and ninety six dinars and 600 \ 1000 dinars," implemented through the 5.264 processes. The highest turnover was in June; trading book during the month was LYD 5,362,626.03 from the number of 269,299 shares through the implementation of the 650 processes. Whereas the lowest value of trading was LYD 1,678,532.500, was in November with the amount of 106,777 shares through implementation of the 374 process (LSM annual report, 2009).

The Libyan stock market witnessed many inside and outside developments in 2009 which led to an improvement of its operations. Trading volume has increased to more than 72 million LYD for more than 600 million shares and through more than 5 thousand processes (LSM annual report, 2009).

In addition, a number of companies listed in the main table, there were more than 15 companies in a sub-list. In 2009 also LSM launched the new website in the market operated using latest technique. The website provides a range of new services of a short message service centre and voice services, which enable the investor to follow up its operations in the market immediately.

Based on the central depository and the registered management, shareholders with more than 25 companies, there are other members involved in the stock market. There are around 250 thousand investors registered in the market and 11 brokerage firms

engaged in buying, selling and providing advice and services to promote the department of subtraction (LSM annual report, 2009).

For the legislative environment, the issuance of stock market law is the most important achievement of the stock market. The issuance of the law has culminated from a great effort in preparing the draft law, workshops and meetings with national experts and Arabs in this area in January 2010, which will open the door to practically economic activities and orderly stock market. The regulatory body controls the organization of financial institutions in a market environment.

At the international level, LSM has succeeded in attracting the attention of the other Arab markets. It received the honour of the presidency of the Arab stock exchanges for the year 2010. Besides, it also got the membership of the Executive Committee of the deposit of Africa and the Middle East (Alameda). It also joined the market to the organization of International protection of the investor and it was one of the first acceded to the Arab markets. In addition, it became a member of the Union of African stock exchanges and attained the membership of the (Al-Ana) Numbering International organization and the World Federation of Exchanges (WFE) as an observer (LSM annual report, 2010).

The number of the increase of investors reached around 250,000, whilst number of Registered Companies became 41. The rise of the average daily trading value became LYD 304,005 in 2010. (According to Libyan Central bank 1\$ = 1.35 LYD). In addition, the daily average trading in 2010 was LYD 304,005.260 in about 7,465 transactions. The number of Brokerage companies in 2010 was 12, and the number of listed companies in 2010 was 25 (LSM annual report, 2010).

In 2011, the market closed on 22/02/2011 because of the war that took place on 17/02/2011 causing it to close for one year until 22/02/2012. For this reason, the study period stopped in February 2011. Table 2.1 illustrates the trading summary of LSM in the study years (LSM annual report 2011).

Table 2.1: Trading Summary of LSM (2008-2010) (1USD 1.35LYD)

Year	Trading value	Trading volume	No. trades	Market Capitalization Value	Turnover Ratio
2008	29,276,065.600	29,276,065	4.231	8747,80,997.50	0.35%
2009	65,548,389.600	5,493,846	5.912	2,654,819.771	1.38%
2010	58,065,004.650	4,513,994	7.514	3,770,649.810	0.24%
Starting from 22 /02/ 2011 The market was closed due to the war					

Source: LSM annual reports (2008, 2009, 2010 and 2011)

### 2.5.3 The Main Obstacles Prevented Earlier Establishment of the Libyan Stock Market

Libya, like many other countries, suffered for a long time from problems within its economy, in especial inflation, balance of payments deficit, low rates of employment and growth. All of them caused to create an imbalance in the economy. Instead, the problems of irregularity in supply and demand affected negatively on prices and balance of payments. Similarly, fiscal policy tended to be more than the level of expenditure, which caused by an imbalance between population densities, growth and employment, which led to the structural distortion in the employment market. Besides, during the 1980s, severe decline in international oil prices and the effect of UN and US sanctions also had adverse effects on the Libyan economy during the early 1990s the major reasons behind the financial crises that Libya faced in the early 1980s and 1990s.

The explanation of Cobham & economics (1995) goes that stock markets in developing countries can suffer from many problems. These problems can be due to an imperfect flow of information and high transaction costs, because of being their economies too small to benefit from the economies of scale which characterise the major stock markets of the world. He also emphasises that in the developing countries, there must be a strong preference for a bank-based rather than a market-based system. Moreover, Fry (1982) points out that:

“At best stock markets play a minor role; more often they resemble gambling casinos and may impede growth in developing countries.”

Despite the importance of the stock market for Libyan economic development, there were some limitations that the absence of a stock creates. Among the limitations and obstacles identified are:

1. The difficulty of predicting and controlling of uncertain circumstances, owing to the issue of the instability rules and regulations without feasibility studies being conducted.
2. The weakness of public awareness of the role of investment the stock market in the economy between the Libyan people.
3. The Libyan banking system is not sufficiently well developed.
4. Most Libyan companies are unable to sell additional shares issued for financing further capital investment.
5. Lack of efficiency and development of financial information institutions and a financial press in this field.

#### **2.5.4 Regulatory Framework of Libyan Stock Market**

Although time to develop a plan for marketing programme offered shares for privatization in Libya in the absence of the stock market, it has been assigned to the offices of the editors of contracts to complete the subscription process. However, after the announcement of the IPO, it faced many difficulties. For example, the investors did not prefer the subscription of shares offered, which led the specialists to review the marketing program of the shares offered. It also led the General People's Committee to take some modifications to the process of legislation, such as resolution number "100" for the year 2004, about identification of controls and the financial value of some economic units for the public purpose of transferring the ownership of these units.

Furthermore, the General People's Committee made a resolution that No. (242) for the year of 2003 to the Libyan Central Bank to establish the LSM, and to delete the Head of Libyan Central Bank's resolution that was about the establishment of the trading

shares department in the investment management. The last resolution No. (134) was issued (in the year of 2006) which was about the establishment of LSM, which is considered an important turning point in the Libyan financial system history.

In addition to that, to make an investment in all sectors more deeply, Libyan government has made impressive changes through issuing many regulations such as, the Law concerning the encouragement of foreign capital investment (law No. (5) of 1997). Also, LSM issued the Law No. (21) of 2001 concerning the practice of economic activities, specifying the tools for it exemplified in individuals and public companies.

In addition to that, the Law No. (9) of 2000 made to control the Transit Commerce and Free Zones; Banking Law (law No. 1 of 2005); and Law on Combating Money Laundering (law No. (2) of 2005). For more details for LSM, regulations, see appendix (2.2).

#### **2.5.4.1 Rules and Regulations of Libyan Stock Market**

Since its establishment, the LSM has been well regulated. Recently there are a number of rules and regulations that organize the establishment and operation of the market's companies. From the formation of the LSM, it was adopting the developing systems and trying to avoid the other market's mistakes. For this reason, LSM prepared regulations governing the market operations and to have fair trading and to protect the rights of sellers and buyers from non-market risks. The law of the stock market aimed to organize and develop companies, and economic institutions, and provide them with needed financial aid. The law of the stock market aims to enact the concepts of transparency, disclosure.

The resolutions and legislation have been coming one by one in Libya for the establishment of the stock market. One of those is the resolution No. (31) for the year 2003 which was about the issuance of a list of estate, the companies and public economic units. Another one was the resolution of the Secretariat General People's Committee No. (313) for the year 2003, on the adoption of the program to re-organize the public companies (expand the ownership base). In addition to that, the capital of

the new economic units has been determined according to the value of the shares subscribed. Besides, the share value is funded directly by the subscribers and the cash payment, but it can benefit from the money, which is available from other sources. The subscription began with some company's shares; that was put up these to the public since the end of 2003 (LSM publication entitled 'the importance of LSM of economic growth, 2009).

In 2007, LSM specialists, in cooperation with international experts, began to prepare regulations governing the stock market's operation, in order to protect investors and ensure the integrity and transparency of transactions in the market (LSM annual report, 2007). These laws include three themes as follows:

1. Internal regulations governing the administration and financial affairs in the market, which was in 2007.
2. The rules governing the market activity were in 2008.
3. The capital market law, which was in 2010, to regulate the activity of the market and establish the Capital Market Authority to oversee and control market transactions.

#### **2.5.4.2 Internal Regulations of Libyan Stock Market**

In 2007, the Board of directors of LSM, made a set of internal resolutions governing the administrative and financial aspects of management and workers in the market which can be listed as follows (LSM annual report, 2007).

1. Regulations for employees on the market.
2. Regulations of training and development.
3. Official missions regulations.
4. Regulations for the Management Committee.
5. Financial regulation of the market.
6. Sanctions regulations.

### 2.5.4.3 The Rules of Libyan Stock Market

In 2008, the LSM prepared a set of regulations, which were issued in the new statute of the market under the General People's Committee Resolution No. 436 in 2008. These regulations are basic rules to regulate the operation of the market to protect the investors, safety of transactions, and application of principles of disclosure and transparency in the LSM (LSM annual report, 2008). In his study, Shernanna (2013) addressed these laws as follows:

#### 1. Regulations of Listing and Disclosure

These regulations involve many of the provisions and rules organising listing companies in the LSM including the formation of a listing committee and their function definition, listing requirements, rules of cancellation of listing, and the disclosure and nature of the data and processes.

#### 2. Depositing and Central Registering Regulations

These regulations contain provisions and rules controlling the process of depositing and registering of securities in the stock market, including the determination of the functions of the depositing and registering department, organising the clearing and settlement process. These laws also include the organize the process of the purchases, sales and inheritance, and take the procedures for seizure and freezing of the securities (Shernanna, 2013).

#### 3. Trading Regulations

These regulations organize securities trading in the LSM, including identifying trading places and times, administrative and technical measures for trading activity, preventing the exploitation of inside information in securities trading, and the prohibition of price- fixing in the market.

#### 4. Brokers' Regulations

These resolutions, governing the brokers' activity in the LSM, including conditions and requirements for a brokerage license, functions and responsibilities of brokers,

and all administrative and technical procedures relating to brokerage activity in the market.

### **5. Fees and Commissions in Libya Stock Market**

These regulations organize determine the value of fees and commissions paid for direct and indirect services offered by the market to clients and stakeholders, including listing fees, membership, brokerage licenses, underwriting, trading, grievances, conciliation and arbitration, and services of depositing and registering securities.

### **6. Corporate Governance**

These control the management of listed companies in the stock market in order to ensure best practices that protect shareholders and stakeholder rights, such as earning distributed profits, get the information, attending and participating in the annual meetings, and voting rights.

These resolutions also include disclosure rules and transparency, including the disclosure of reports and financial statements, and the reports of boards of directors. They also contain all issues relating to boards of directors and supervisory committees, such as their basic responsibilities and duties, remuneration of the members, and conditions on the composition and independence of these committees. It should mention that this regulation is not mandatory for listed companies, except for the rules on disclosure of financial reports and reports of boards of directors.

### **7. Sanctions in the Market**

This regulation involves measures relating to the impose sanctions on any procedure that contravenes the provisions of the statute, rules and regulations of the market. It includes a number of issues such as the formation of the sanctions committees, determining their tasks, specifying the violations and sanctions, and other matters related to appeals against the decisions of the sanctions committees.

## 8. Grievances

This regulation includes procedures relating to grievances about decisions of the sanctions committee, board of directors, or the management of the market. It addresses the formation of an appeals committee, determining its functions and mechanism of action, and all the complaints procedures.

## 9. Regulation of Conciliation and Arbitration

This regulation governs the function of settlement of disputes that may arise between traders and dealers in the market, including all important procedures to complete the process of conciliation and arbitration.

## 10. Regulation of Settlement Guarantee Fund

This regulation includes all the rules controlling the operations of the Settlement Guarantee Fund, which contains the compilation of contributions from dealers in the market for the implementation of the settlement directly to their accounts, in order to ensure the fulfilment of the obligations arising from trading operations in a suitable time, and creating confidence in the trading market, thereby encouraging local and foreign investment dealings in the market.

Based on this regulation, all brokers operating in the market have to participate in the Fund and pay subscriptions. The regulation specifies the value of contributions by members, the capital of the Fund, measures and operational rules of the Fund's daily work, and the settlement of disputes and grievances concerning the administration of the Fund and its members (Shernanna, 2013).

According to the above regulations, therefore, that LSM establish an integrated legislative framework, which contains the trading rules of the market that will protect investors from non-commercial risks and ensure the integrity and transparency of transactions in the LSM.

## 11. Law No. (11). 2010 on Libyan Stock Market

In January 2010, the Law No. (11) on the capital market was issued, which is divided into eight parts to organise all aspects of capital market activity, and can be summarised as follows:

The first part of this regulation, which includes fourteen articles, provides for the establishment of an independent supervisory body operating under the supervision of the Ministry of Economy, it calls the Capital Market Authority. This body seeks to create a suitable environment to achieve stability and growth of the capital market through a series of goals such as protection of investors and traders from non-commercial risks, ensuring the integrity and transparency of market transactions, and reducing risks coming from financial transactions (Aljbiri, 2012).

To achieve these objectives, the law sets out a range of tasks to be undertaken by the Capital Market Authority, which can be summarised as follows:

- i. Regulating and controlling the issuance of securities.
- ii. Regulating and controlling the disclosure of important information for investors.
- iii. Gathering information and statistics regarding the capital market, and publishing its reports.
- iv. Receiving and following up complaints and reports relating to market activity or intermediaries, and taking suitable decisions including the imposition of sanctions.
- v. Ensuring the implementation of the accounting and auditing standards in the preparation of final accounts and financial statements of actors in the market.
- vi. Imposing the standards of corporate governance for listed companies and all the workers in the field of securities.
- vii. Issuing and giving of permits and licenses necessary for the exercising of activities related to the capital market.
- viii. Adopting a suitable system to ensure the fulfilment of the obligations arising from trading operations.

- ix. Adopting a proper system to protect clients in securities, including effective means to compensate those affected by non-commercial risks.

Furthermore, this section determines the entities subject to the observe and supervision of the Capital Market Authority, including the institutions which deal in securities, involving the stock market, issuers of securities, brokerage companies, accounting and audit offices, investment funds, and financial consulting offices (Shernanna, 2013).

The second part of this law, which contains nine parts, provides regulations for the issuance process of the security types, and important procedures for public subscription, also, the listed companies' obligations in the market, such as the disclosure of important data and information related to all administrative and financial activities of these institutions.

The third part, which includes seven sides, organizes the activity of the LSM and determines its goals and functions; it also clarifies all administrative and financial affairs of the market, such as budget, resources, and the formation and functions of the board of directors.

Part four, which involves fifteen articles, regulates the activity of the working entities in the market, including the identification of these institutions that operate in securities, organizing their activity and clarifying their obligations.

In addition, this part includes the obligation of all actors in securities to disclose all information, data and statistics, involving the statute, financial statements certified by an external auditor, an annual list of the shareholders, any important information affecting the price of securities, or as the rules and legislation requirement.

Part five, which contains nine articles, regulates the issues which have a relationship with the investment funds, including the establishment of these funds, administrative and financial affairs of funds, responsibilities and functions of their management committees.

Part six, which contains six parts, regulates measures for the settlement of disputes, involving the formation of committees of investigation, disciplinary matters, grievances, and conciliation and arbitration, adding to identifying the functions and powers of these committees.

Part seven, which includes five articles, sets sanctions for all practices that contravene the provisions of the regulations in the field of securities.

Part eight, which includes thirty-three items, provides a series of general rules governing the collection of important aspects of the stock market, such as identifying listed companies in the market and their securities listing according to the conditions required by the regulations for the listing process.

In addition, this part presents the incentives for any listed companies trading in its securities in a not less than a sixty day period, per year, such as exemption from income tax reach five years with the possibility of reducing the tax to 50% over this period, and exemption from customs duties of up to 50 percent.

Moreover, this section stresses that the stock market must disclose all important data and information, and present financial statements, trading reports, and reports of any exigent circumstances. Also, it prevents members and the staff in the market from trading securities without the approval of the Capital Market Authority CMA (Aljbiri, 2012).

In summary, The LSM statute involves all rules and regulations controlling its operations, which supposed to protect investors from non-commercial risks and ensure the integrity and transparency of transactions in the market. However, there was an obvious delay by the relevant authorities in issuing the law in 2010 of the stock market and allowing the establishment of an independent body to supervise and control all the processes taking place in the stock market. However, the stock market has been operating since 2006. In addition, so far, the related authority has not issued the regulations of this law, and had not established the Capital Market Authority for supervision and control.

Finally, despite the statute of the LSM indicates that all listed companies with capital exceeding LYD 250 million are obliged to register in the stock market, only 12 companies currently appear on the main list, and only 13 companies appear on the sub-list of the market.

Besides, the issuance of the regulations of the new law is significant to force all companies to enrol in the market as provided for in article 67 of the new law, thereby ensuring the protection of investors' rights, the integrity of transactions, disclosure and transparency, and the application of standards of corporate governance stipulated by the new law.

### 2.5.5 Libyan Stock Market Structure

The establishment of the LSM is a significant step in the contribution towards improving the economy's financial organizations; in order to enable it to realise a better utilisation of financial resources by mobilising domestic savings, attracting foreign savings and channelling these resources to productive projects through the development of the stock market.

On 3 June 2006, General People's Congress GPC made a resolution No. (134) regarding the establishment of a stock market in Libya. In 2010 LSM listed twelve companies divided into four sectors, each of which has its own speciality, they are:

1. Banking Sector
2. Insurance Sector
3. Investment and Financial Sector
4. Industrial Sector

On the other hand, the administrative structure of the Libyan capital market consists divisions of the following organizational (LSM publication, Libyan Stock Market structure of LSM "2008").

- i. Trading Department

- ii. Central Listing and Depository Department
- iii. Membership and Administrative Affairs Department
- iv. Financial and Administrative Affairs Department
- v. Research Studies and Development Department
- vi. Control Oversight and Supervision Department
- vii. Legal Affairs Department
- viii. Public and Quality Relations Department
- ix. Communications and Information Systems Department
- x. Committee Affairs office
- xi. Office of Technical Cooperation
- xii. Office of Internal Audit

In his study Aljbiri (2012) addressed that at the beginning of its establishment LSM composition was strongly supporting by financial sector companies, with banks and insurance attracting the large quantity of share of investment flows. Also in 2010, the banking sector was the main sector in the market, equalling 73 percent of market capitalization; followed by insurance companies 19 percent, financial service 4 percent, and industrial sector 2 percent. In addition to that, most of these firms are public companies, and some of them were suffering from many problems for instance, in terms of disclosure, financial deficit, accounting standards. In addition to that, the companies listed in LSM were not getting good profits in Libyan economy. Since the beginning, the government had used banks and insurance companies to make a strong starting into the Libyan Stock Market (LSM) and privatization efforts in general, and then slowly push them into the private sector. In addition to that, the number of publicly listed firms is quite low, relative to the number of firms in the economy. Libya has many profitable companies such as the telecommunication and industrial categories, and oil companies, both linked to highly profitable growth sectors are set to attract local and foreign investors, and improve the daily trading volumes and market capitalization.

Since 2010 LSM expected to join Telecoms companies (Libyana and Al Madar), (the Libyan Iron and Steel Company) to its listed companies to acquire more depth and sector diversity. The sale of as many as 40 percent of the stake in two government-owned mobile phone networks, Libyana and Almadar, was expected to surpass previous IPO proceeds. The oil companies, both private and public, might be listed in the stock market, if the basic conditions are available. However, the annual report of LSM 2010 indicated that there are more than 22 companies listed in sub-table when the conditions will be ready, and they are from different sectors. However, oil and telecom companies did not join the ranks of LSM listed companies until now. However, there are plans to attract these firms because they play a strong role in the Libyan economy (LSM annual report, 2010).

Otherwise, the Libyan stock market did not have a variety of financial instruments, because only one instrument exists for investors who are equities; there is no bond instrument until now. Also, as mentioned before, few companies, mainly banks, insurance are listed on the market, which means that the most profitable companies did not list in the LSM yet especial oil and telecom firms. Chart 2.3 shows the structure of LSM based on listed companies.

Figure 2.3: Structure of LSM Based on Listed Companies



Source: Libyan Stock Market report 2010

### 2.5.6 Libyan Stock Market Characteristics

Libya did not have any experience about the stock market operations. Thus, it was in need to benefit from the other Arab countries' experiences; especially from Egypt and Jordan in the area of staff training and the preparation of regulations and controls necessary for the functioning of the market.

The LSM contains a huge range of participants, which include companies, individual investors, institutional investors, financial instructors and dealers with assigned responsibilities. The continuous trading system is a basic rule of the trading market. Each company has an assigned board at the trading office, and execute all trades have to via a licensed broker in the office. In the middle of 2008, there were 15 brokerage firms licensed by the Libyan stock market to trade in it. They can also buy and sell the equities on behalf of their customers against the commission and sometimes for their own account. While their legal unit and nature takes the form of a limited liability company, it may be so that the two may comprise a partnership functioning solely as a broker (LSM annual report, 2008).

Despite the presence of diverse groups of investors in the LSM, especially in the secondary market, the breakdown of various types of investors is not recognised. There is no available information about the individual investor's percentage as opposed to institutional investors; therefore, this type of information is vital. Clearly, the primary institutional investors in Libya consists of insurance companies, banking institutions, the Libyan Investment Corporation (government agency), saving funds, and different employee provident and investment funds. While, the first two institutions have been mainly net buyers in the market, they do not frequently participate on the selling side.

Libya was in need to benefit from the other Arab countries in the area of training and the preparation of regulations necessary for the functioning of the market because LSM is infant market by the lack of the experience in this field.

In the first year (2006), the stock market did not do any operations because it was the establishment year. In 2007, the trading was very small, and it was a handy trading.

Also, the number of contributing companies was very limited, and there were no public and foreign investors at all. The number of contributing companies almost reached 6 (LSM annual report, 2007). However, the system began to change on the 3rd of April 2008, when the stock market started to use an electronic trading; when increases the volume of transactions in the market after connecting the central system and the Settlement Guarantee Fund. After that, it was linked to the headquarters of the market in Benghazi and Tripoli, by being linked electronically using fibre-optic links and also with the satellite. Later on, the number of listed companies increased, which reflected the success of LSM as an emerging market in the first phase (LSM annual report, 2008).

After all that, LSM invested sufficient time for the start of electronic trading and implementation of business strategy, information management for many Arab and international markets and the mechanism of action and systems that safe environment to attract the investors. Subsequently, the General People Committee made a resolution No. (436) of 2008 on 16-11-2008, to establish the statute of the market and increase its capital to LYD 50 million. It also provided requirements for the session for IPO for the public and private sectors, and its transformation into a joint stock company owned by a number of legal entities, and more than 1400 regular contributors (LSM annual report, 2008).

### **2.5.7 Libyan Stock Market Trading System**

Trading system in the stock market is the process of buying and selling securities of listed companies through authorised brokers in the market.

The security traded in the LSM is divided into two groups: equities and debt instrument. The buying and selling of orders were achieved by licensed brokers and implemented based on continuous action during trading hours. The passing of customer orders by telephone or verbally, thus, is acceptable as long as such orders are subsequently confirmed either by order forms accordingly completed and signed by customers, or by a corresponding statement transmitted in written form.

Trading for the officer occurs in units, each worth LYD 50 of nominal value of the shares. Most shares have a nominal value by LYD 1, with the exception of equities whose average ranged between 8 to 10 LYD, such as the Wahda Bank, Tripoli Regional Bank, Cement Regional Company, Suq Al-Gumaa Regional Bank and United Company for Insurance with a nominal value of LYD 10. Therefore, among brokers take place a spot basis at (T+1); quoted the prices of shares in LYD; which increases with the greatest change of 5 percent on the previous day's close compulsory on the daily movement of a share.

Subsequently, the ceiling is applied to prevent the large price fluctuations to eliminate speculation and to protect the small investors' interests. The exception to this rule happens just when there is a requirement of a stock dividend and price adjustment, or when listing a company originally, in this case its price is floated for 15 minutes and, then they set the base price for that day. Obviously, the LSM provides an up-to-date record of all transactions and all register traded shares. The registration might occur on the day following the trading day, when the brokers record the transaction with the Libyan stock market. The latter is given two subsequent business days to update their records and to deliver all transactions (tighten) to the issuing companies who should resultantly update their records within three or so business days (Masoud, 2009). Table 2.2 presents further details on the trading volume in the LSM in the period 2008-2010.

Table 2.2: Trading System on Libyan Stock Market during the Period (2008 – 2010)

Statement	No. of Trades	Trading volume	Trading Value (In Million) (LYD)
<b>2008</b>			
Actual trading	4231	1,349,216	29,276,065.60
Ownership transfer	1032	784,012	8,092,711.00
Protected Deals	1	2,052,000	390,413,520.00
<b>Total</b>	<b>5264</b>	<b>4,385,228</b>	<b>427,782,296.60</b>
<b>2009</b>			
Actual trading	5912	5,493,846	65,548,389.60
Ownership transfer	23	672,872	6,755,720.00
<b>Total</b>	<b>5935</b>	<b>6,166,718</b>	<b>72,304,109.60</b>
<b>2010</b>			

Actual trading	9545	6,069,066	77,948,216.48
Ownership transfer	53	336,170	3,361,700.00
Protected Deals	9	10,160,000	105,878,000.00
<b>Total</b>	<b>9607</b>	<b>16,565,256</b>	<b>187,187,913.48</b>

Source: Libyan Stock Market annual reports 2008, 2009 and 2010

The trading value in the LSM increased clearly during the period 2008-2010. In 2008, it was to LYD 29,276,065.600 and reached LYD 65,548,389.600 in 2009; finally, in 2010, it increased to LYD 77,948,213.480. Trading volume also took increasing trend during the study years; in 2008, it was 1,549,216 while, in 2009, it developed in 5,493,846, then increased to 6,069,066 in 2010. This trend came from the increased of the number of trade during the study years. Although the value of total trading in the years shown in Table 2.2 was high, except in 2009. During this year, the value of the actual trading was small compared with the other two years. It should mention that this increase in the total trading value was the result of protected deals conducted in the LSM in these years. In 2008, there was a huge protected dealt with a value of LYD 390,413,520.00 which equivalent to more than 91 percent of the total trading recorded in the LSM in that year. This deal was the operation of privatising 19 percent of Al Wahda Bank shares of the Arab Bank. Also, in 2010, nine protected deals were conducted in the LSM with a value of LYD 105,878,000.00 which represented about 56% of the total trading recorded in the market. These deals were between the Economic and Social Development Fund (ESDF) and Privatisation Agency in the context of privatising public companies.

According to the annual report of the LSM, in 2010 the securities of Gumhouria Bank were the most active in terms of value and volume of trading; the trading value was LYD 16,734,255.24 which equivalent to 21.5 percent of the total actual trading value. Moreover, the trading volume of Gumhouria Bank securities was 1,260,176 that was equivalent to about 20.8% of the total actual trading volume in 2010. The Sahara Bank comes second, with a trading value of LYD14,697,232.78 which equivalent to about 19% of the total actual trading value. Furthermore, the trading volume of Sahara Bank securities was 1,143,839 which equivalent to about 18.8 % of the total actual trading volume in. Meanwhile, the securities of the National Cement Company were the least

active traded in; the trading value was LYD 278,839.58 which equivalent to about 0.4 percent of the total actual trading value. Meanwhile, the trading volume was only 22,999 which equivalent to about 0.3 percent of the total of actual trading volume. (LSM annual report, 2010). Table 2.3 illustrates the volume and value of Trading of companies listed on LSM in 2010.

Table 2.3: The Volume and Value of Trading of Companies Listed on Libyan Stock Market in 2010

Company	Trading Volume	%	Trading Value (In Million)	%
<b>Gumhouria Bank</b>	16,734,255.24	21.5	1,260,176	20.8
<b>Sahara bank</b>	14,697,232.78	19	1,143,839	18.8
<b>Commerce and Development Bank</b>	14,096,153.64	18	744,986	12.3
<b>Al-Wahda Bank</b>	9,263,925.61	12	788,340	13
<b>Libyan Stock Market</b>	7,911,370.94	10	838,116	13.8
<b>Libyan Insurance Company</b>	5,438,053.90	7	536,641	8.8
<b>United Insurance Company</b>	2,237,969.51	2.8	105,548	1.7
<b>Sahara Insurance Company</b>	2,258,873.29	2.9	177,679	2.8
<b>Assaray Bank</b>	1,032,371.02	1.3	139,600	2.3
<b>National Commercial Bank</b>	3,552,200.02	4.5	284,808	4.7
<b>Mediterranean Bank</b>	446,967.95	0.6	26,334	0.4
<b>National Cement company</b>	278,839.58	0.4	22,999	0.3
<b>Total</b>	<b>77,948,213.48</b>	<b>100</b>	<b>6,069,066</b>	<b>100</b>

Source: Libyan Stock Market annual report 2010

On the other hand, the main list of the LSM includes six privatised companies based on the privatization programme, these companies are: the Libyan Insurance Company, Gumhouria Bank, Sahara Bank, Al Wahda Bank, National Commercial Bank and the National Cement Company. These companies and banks represent about 85 percent of the total capital of companies listed on the LSM. Furthermore, the total trading value of these companies in 2010 was LYD 49,964,477.13 that was equivalent to 64 percent

of the total actual trading value in the LSM. Likewise, the total trading volume of these companies in 2010 was more than four million securities, equivalent to more than 66 percent of the total actual trading volume in the LSM. In addition, the protected deals conducted in the stock market concerned the privatisation of public companies and banks to strategic investors. Therefore, it is clear that the privatisation of state-owned enterprises had a positive impact on the capital and activity of the LSM. At the same time, the market has played an increasing role in the sale and privatisation of public sector enterprises (Shernanna, 2013).

### 2.5.8 Libyan Stock Market Main Indicators during the Study Years

During the study years, stock market main indicators had reached different up and down levels. Table 2.4 shows the trend outlook on them.

Table 2.4: Libyan stock Market Main Indicators during the Study Years

Year	trading days	Index (IDX)	Trading Volume	Trading Value	Market Capitalization	Total average of Value
2008	186	796.75	1,549,216	29,276,065.60	874,780,997,50	157,398.20
2009	253	1104.28	5,493,846	65,548,389.600	2,654,819,771,00	259,084.544
2010	191	1295.04	4,513,994	58,065,004.650	3,767,773,648.000	304,005.260

Source: Libyan Stock Market 2008, 2009, 2010 annual reports.

The above table explains the trend of the main LSM indicators between the study years. Number of trading days improved from 186 in 2008 to 253 in 2009. However, it started to decrease to be 191 in 2010. On the other hand, the index increased during the study years, and it was 796.75 in 2008 to become 1295.04 in 2010. Trading volume took a fluctuating trend, it was 1,549,216 in 2008 then increased to become 5,493,846, in 2009, and then decreased and reached 4,513,994.

Besides, trading value also took a wave trend until arrived at LYD 65,548,389,600 in 2009, and then started to take down trend to be LYD 58,065,004.650. Moreover, market capitalization increased between the study years to be LYD 3,767,773,684.000. The same trend was in total average of the value it was 157,398.20

in 2008, but it became LYD 304,005.260 in 2010. Based on that the year of 2009 was the best year between the study years because there are many events happened in this year, such as the enrolment LSM Company in the listed companies. Also, many companies moved from the sub-list to the main-list such as Al-Gumhouria bank and Cement Company. The importance event is launching a new price index; this index has many advantages such as Does not focus on a particular sector, and, therefore, provides a fair distribution for all sectors.

### 2.5.9 Libyan Stock Market Performance

Stock market performance reflects its contribution in the economic growth. It could be judged by the ratio of market capitalization to economic growth Karim et al., (2012) In their studies Ash & Huizinga (1999) and Ben Naceur & Goaid (2008) pointed that a well- developed stock market lead towards higher growth not only in corporate but also the whole country. Table 2.5 shows the performance of LSM during the study years as follows:

Table 2.5: the Performance of LSM during the Period (2008 – 2010)

Year	LSM performance: Market Capitalization / GDP %
2008	17.416
2009	53.252
2010	73.435

The table made by the researcher based on LSM annual reports, 2008, 2009, and 2010

According to the above table, it could be noted that the performance of the LSM increases during the study years. In 2008 it was 17.416 then increased sharply until reaching 73.435 in 2010. This indicates that this result supports the achievement of the second objective of the study that is the performance of LSM good compared with its establishment date.

### 2.5.10 Listed Companies and Financial Institutions in Libyan Stock Market

As previously stated the number of listed companies was very limited in the first two years of trading. Afterwards, the list elongated reflecting the strong growth of the

Libyan stock market. This section would present the total number of listed companies and financial institutions which in the LSM.

In 2006, there were only three listed companies in the banking and insurance sectors, this number increased to six companies in 2007 divided between banking and insurance sectors. During the study years the number of the listed companies in the main-list and sub-list increased (LSM report 2010). The following sections explain the LSM companies in the two types of lists.

### 2.5.10.1 Listed Companies in Main-List in Libyan Stock Market

In 2008, when LSM started using the electronic trading, main-list and sub-list are produced. The main- list includes companies registered in the market that have met all registration and listing conditions; thus, they trade their securities in the main market. There were eight companies in the main- list. Then, in 2009, the number of companies increased to ten on the main list.

In 2010, the number of listed companies in the main- list increased to twelve. These companies operate in different sectors; on the main list there are seven companies from the banking sector and three from the insurance sector. While, from the industrial sector there is one company on the main- list. From the financial services sector, the LSM company is included on the main list. Table 2.6 illustrates listed companies on the main-list in LSM.

Table 2.6: Listed Companies in the Main- List in Libyan Stock Market in 2010

Company	The Capital (Thousand LYD)
<b>Banking Sector</b>	
Al Wahda Bank	108,000,000.00
Sahara Bank	252,000,000.00
Assaray Bank	50,000,000.00
Commerce and Development Bank	33,333,330.00
Gumhouria Bank	200,000,000.00
National Commercial Bank	33,333,000.00

Mediterranean Bank	100,000,000.00
<b>Insurance Sector</b>	
United Insurance Company	10,000,000.00
Libya Insurance Company	70,000,000.00
Sahara Insurance Company	15,000,000.00
<b>Financial Services Sector</b>	
Libyan Stock Market	50,000,000.00
<b>Industrial Sector</b>	
Nation al Cement Company	600,000,000.00
<b>Total</b>	<b>1,488,666,660.000</b>

Source: Libyan Stock Market annual report 2010.

### 2.5.10.2 Listed Companies in Sub- List in Libyan Stock Market

In 2008, there were nine companies in the sub - list of the market. Meanwhile, in 2009 there were sixteen. Conversely, in 2010 sub-list was contained thirteen companies, from the industrial sector there are eight companies, while the services and tourism sectors have four companies and one company respectively, listed on the sub-list of the market. National Company for Flour Mills and Fodder and Oya Tourism Investment Company have the highest capital which is LYD 300,000,000.00. Meanwhile, Development Company for Refining of Vegetable Oils has the lowest capital that is LYD 14,230.000.00. The total capital of the sub- companies is LYD 1,891,453,638. Table 2.7 shows the listed companies in sub-list in LSM.

Table 2.7: Listed Companies in Sub-List table in Libyan Stock Market in 2010

Company	The Capital (In Thousands)
<b>Industrial sector</b>	
Libyan Company for Tobacco	75,780,000.00
Development Company for Medicines and Medical Supplies	90,069,530.00
Development Company for Pipes	32,210,000.00
Development Company for Refining of Vegetable Oils	14,230,000.00
Development Company for Tubes	35,000,000.00
Development Company for Wires and Cables	78,850,000.00
Development Company for Engineering Industries	36,900,000.00
National Company for Flour Mills and Fodder	300,000,000.00
<b>Service Sector</b>	

Al-Rahila Company for Oil Services	50,000,000.00
Development Company for Medical Services	87,414,108.00
Development Company for Construction	100,000,000.00
Development Company for Food Imports	100,000,000.00
<b>Tourism Sector</b>	
Oya Tourism Investment Company	300,000,000.00
<b>Total</b>	<b>1,891,453,638.00</b>

Source: Libyan Stock Market annual report 2010.

On the other hand, in 2010, twenty companies from various sectors signed listing agreements with the LSM; it was expected to improve their liquidity and increase their trading volume in the market. Table 2.8 shows the companies signed listing agreements in LSM during the study years.

Table 2.8: Companies Signed Listing Agreements with the Libyan Stock Market

Company	Profile
Libyan Iron and Steel	Libya Company for Cables
National Investment Company	Development Company for Agricultural Investment
Al Madar mobile phone Company	Development Company for Import Transport Tools
Libyana Mobile Phone Company	Libyan Company for Health Facilities
Industrial and Services Investments company	Libyan Company for Financing and Leasing
Tourism Investment and Real Estate company	Investment Company for Advertising
Building Materials Industry company	Libyan Company for Health Insurance
Libyan Joint Company for Cement	Pharmaceuticals And Medical Equipment company
African Company for Cement	The Import of Construction Materials company
United Air Company	Airline Oil Company

Source: Libyan Stock market annual report 2010

The number of companies listed in LSM is quite small because of the market's limited life. However, it can be said that the risk is high in the market, and the investors do not have the principle of diversification due to the limitation of listed companies in LSM.

To conclude, in future the Libyan government plans towards privatization would be quite effective. Market reforms will help the stock market to be strong enough to increase the number of listed companies. Besides, the government made a decision that will provide some incentives to listed companies in the market that will be done by giving those companies listed in the tables of the market. There are no deals on its securities. However, these incentives would attract more companies to register in the LSM in future.

### 2.5.11 Brokers Companies in the Libyan Stock Market

For trading in the financial markets, Brokerage companies are the intermediaries. The success of financial markets depends on the success of related parties such as investors, corporations and brokerage companies. Brokerage companies are the core entity in the financial market to link up the investors and the stock market. They assist the investors to access the market at the lowest cost. Specifically, they provide the financial consultation regarding investments for their customers and recommend them to subscribe to securities, according to the applied laws and regulations (LSM annual report, 2010). Table 2.9 shows the brokerage companies in LSM during the study years.

Table 2.9: Brokerage Companies in LSM during the Study Years (2008 – 2010)

No	Name of company
1	Altadamon company
2	International Belton company
3	Sarab company
4	Almassar company
5	Green Aproz company
6	Libya for service financial company
7	Foreign Exchange company
8	International Arab company
9	Annour company
10	The National group
11	Alwaseet Almobasher company

Source: LSM annual report 2010

The above table illustrates the brokerage companies in LSM, the number of these companies was six companies in 2008, then it was increased to 12 in 2009 but at the

end of 2009 this number declined in 11 when Universal Financial Investment company stopped its activity.

### 2.5.12 Libyan Stock Market Index

On 30/04/2008 LSM introduced the Electronic Trading System (ETS) at the first time starting from a base of 1000 in April and closing at the highest level at 1207.6, then started to decrease until it arrived the lowest level at 749.55 in November. After this point, it started to increase again at the end of the year and rose to the level of 796.75, down by 203.25 points, or 20 percent. It is clear that the second quarter of the year 2008 was relatively volatile. The most significant reasons for the decline in 2008 influenced by the fluctuation of movement of prices of companies involved in the calculation of the index (LSM annual report, 2008).

During 2009, the LSM index has jumped by 40 percent in August reaching 1018.79 points and still around this level till the end of the year. Despite the global crisis, the LSM managed two successful IPOs in 2009, while sell-offs were limited to the 10-15% range (LSM annual report, 2009).

In the year of 2010, the LSM index had jumped to 80 percent, reaching 1600 points, which represent the highest level since 2008. After that it closed the year at 1354 points, the banking index went up by 134 percent, insurance by 98 percent, services by 78 percent, and industry by 15 percent. However, the performance of the LSM during 2009-2010 was exceptional and unprecedented (LSM annual report, 2010).

#### 2.5.12.1 The Idea of A new Index for the Libyan Stock Market

From the beginning of September 2009, the LSM started using a new price index, which has far more benefits than the old one. For example, it is a composite index that contains the active papers in the stock market, choosing them according to the trading volume; provided that the price is stable and close to fair value. Without being weighted according to the market's capital this indicator also measures the change in the price of papers, and it does not focus on the special sector and hence provides a better distribution of the sectors.

Like other financial markets, the LSM launched a new index in order to diversify the indicators to provide tools that have a wider price for investors to follow the market operations through it. The following paragraphs will apply and introduce some of these ideas.

New method includes the pricing index that is not weighted by quantities. The most important characteristic of this indicator is:

1. Composite price index consisting of the most active-listed stocks in the market, which are chosen according to most heavily, traded values, and that have a stable price comparable to its fair value.
2. This index measures the change in stock prices without weighting them by the capital market.
3. This index does not consider the percentage of free trading.
4. It does not focus on a particular sector, so, provides a good distribution of the sectors.

The index is calculated according to the following equation:

$$\text{The index value at the time } t = \frac{\text{Total of companies prices at the time } t}{\text{The denominator}} \quad (2.1)$$

The total closing prices are calculated according to the weighted closing price method by quantities.

**The denominator:** The denominator is the total conversion of the closing price factor of stocks, including in the index to its level. This denominator derives from the starting point in the index (base date), by dividing the total of the closing prices of companies on random number or multiplier (for example 1000) to be the starting point for the index.

$$\text{Denominator} = \frac{\text{Total of closing prices of securities listed in the base day}}{\text{The index value in the base day}}$$

(2.2)

The first period is determined to launch the index that was 01/09/2009. The securities included this indicator as 5 active stocks while they should determine the previous period and should exclude the inactive one. Thus the securities when entered into the index calculation are as follows Al-Sahara Bank (ASB), Trade and Development Bank (TDB), Libyan Stock Market Company (LSMC), Al-Wahda Bank (AWB), Libyan Insurance Company (LIC) and Al-Gumhouria Bank (AGB). By reducing the nominal value from 100 to 10 dinars per share, United Insurance Company was added after dividing the share. LSM started to use the experience of the index of the electronic system, starting from 30th July 2009. For more details about LSM index see appendix 2.1.

### 2.5.13 Information Technology Development in Libyan Stock Market

In April 2008, LSM started its Automated Trading System (ATS) based on the Egyptian model. This new computerized system was designed to make the market more transparent and efficient, and it complements the Central Clearing Depository System (CCDS) introduced in 2008.

From the beginning of its establishment, LSM has conducted a new system of information technology (IT), in order to work with standards and specifications of international stock markets. These IT works include such as installing the technical equipment (servers), connecting them by fibre optics, installing an electronic system related to trading, depository, clearing and monitor, forming internal computer network with the standards of the market and protecting it by protecting programs. These measures emerged with preparing bank data related to the technical department in the market by connecting them to the internet.

In this regard, lots of agreements were included to make the efficiency of the market stronger; such as, signing contracts about income and install trading, clearing and

control systems signing an understanding memo with NCDX and MCX Exchange in India.

On the other hand, LSM made a cooperation agreement with London Stock Market and an agreement with Arab society of certified accountants in Jordan. Moreover, LSM reports that contain annual data showed that more than 6.075 million Libyan dinars were the cost of technical equipment's in LSM. So, it can be said that the Libyan stock market had an effective experience of international and other Arab countries in capital markets that would develop the market regarding information technology, which eventually would increase the stock market efficiency.

#### **2.5.14 Libyan Stock Market and Other Emerging Stock Market Experience**

Over the last decade, so many Middle East and other emerging economies of the developed countries around the world have established their stock markets that helped these countries to develop their own private sector investment within their own economies and economic infrastructures. Along with this investment, this measure strongly affects trade and indeed established a solid base for technological trade in these nations.

In 1996, the number of stock markets throughout the world continued to rise, which constituted almost 60 percent of the entire world stock markets with a total capital of around 1.9 trillion US\$. As a result, in these countries, liquidity has increased even faster, and turnover jumped from 26 to 85 percent of emerging market capitalisation between 1985 and 1999 (Levine, 2003). Latin America witnessed the greatest increase in the market capitalisation (down 36 percent post-July 1997) before recovering by mid-1999. Also in Asia, it declined from 9.2 percent in June 1997 to peak by the end of 1999. However, the Middle Eastern stock markets have different efficiency of equity stock markets in developed countries because many of them are small, some are new, and others have been successfully closed to foreign investors. The whole Middle Eastern market accounted for about 0.9 percent of the world stock market capitalisation and 8.0 percent of emerging market capitalisation by the end of 2001 (Smith, 2007).

In his study Gentzoglanis (2007) tested the stock market performance and economic growth in four Arab countries. He found that the reduction in economic growth occurred worldwide when the share performance in the Egypt stock market is very weak, particularly after the 11th September 2001. Foreign brokers' transactions declined to about 6 percent in March 2002 from a total 25 percent, whilst the Hermes share index was at its lowest level for 8 years. Morocco was another example of a badly performing stock market; this situation came from a number of factors: the poor results of listed companies, government failure to float some capital of privatised companies on the nation's stock exchange, lack of investor interest in emerging markets. Furthermore, in January 2002, the launch of new indices failed to increase interest in the equities, and the stock market also failed to renew itself. The key share index (IGB) decreased about 7.4 percent, after a 15.3 percent decline in 2000, with 13 percent fewer transactions by 60 percent less by 2000.

The same case was in the Tunisia stock market where activity was very limited as the issues accounted for 90 percent of the primary market. There was a lack of the foreign investor in the financial market. Differently, Jordan's "Amman Financial Market" was more active as it was very open to foreign investors and was the fastest growing stock market among its neighbours. It had a market capitalisation close to 5 billion US\$, providing the ratio of a market capitalisation to GDP of around 77 percent (Gentzoglanis, 2007).

The market capitalisation growth rate has increased by 158 percent during the last five years. However, by separating the regulatory function from the technical side of the stock market, Jordan introduced a modern Securities' Law to create a regulatory body, which led to an increase in investors' confidence to invest. Correspondingly the flow of information among the market institutions, investors and participants were made transparent, and the creation of sophisticated and administrative functions within market institutions helped the Jordan stock market to be a good model as a successful market. Likewise, Jordan's financial market is well placed to be more competitive. As a result, the government created four other bodies, i.e. The Jordan Stock Exchange (JSE), Jordan Stock Depository (JSD) and Jordan Securities Exchange industry to

represent the private sector (JSEC) besides providing proper training in securities dealing (Gentzoglani, 2007).

### **2.5.15 Positive Effects of the Stock Market on the Economy**

This section will list the potential impacts of the development of the stock market on the economy.

#### **2.5.15.1 Area of Finance**

The stock market can help to correct the imbalance funding that may arise from using the sources of short-term financing (bank loans) in the financing of long-term assets (furniture, equipment and buildings). The reason is that, some of the market companies do not take the matching principle and homogeneity when they use it to finance, which provides for the need to Homogeneity between the ages of religion and the age of assets invested from the company. In addition, the stock market can help to improve the rules, systems and decisions which will help draw the general policy on funding and lending (LSM publication entitled, "the importance of LSM of economic growth).

#### **2.5.15.2 Area of Investment**

The reports of observation during the years 1989-1990 indicated that the public sector used the economic resources in an inappropriate way. The same reports mentioned that some projects are selected on the basis of social or political circumstances purely while the creation of some projects occurred in areas far from markets and sources of raw materials. This situation may produce the over investment which comes from the projects that have negative value at present.

Regarding the foreign investment, the foreign investors prefer to invest in the financial assets instead of investing in the real assets. The reason is that they do not want to face problems which have a relationship with the company's establishment, so they are searching for existing company and buy its shares to implement their investments.

There is another type of investors who live in oil consumer countries and they feel that there is a high risk on their investments that come at the oil prices. Therefore, to reduce this kind of risk, they avoid putting their investments in their countries. If the LSM was not an efficient market, it would assure preventing the investors to invest in the country. For this reason, they will search for other countries that have more efficient markets so that they can achieve their objectives, investments and diversification of the investment portfolio.

The stock market can increase the growth of GDP, control the budget deficit as well as reduce inflation rates. The effect of the market is not very prominent in the short run, but it has an exponential impact in the long term. It is because the initial increase that occurs in real economic activity will lead to a wave of optimism about the future, thereby, increase the movement of dealing in the stock market, high prices, and that will in turn result in more investment opportunities. It would help the mutual effects of the stock market and real economic activity in accelerating the rate of economic growth and development. The following section states the uses of economic growth study of a country.

### **2.5.15.3 Mechanism for Determining the Structure of Interest Rate**

Stock market contributes to setting interest rates, and this is done using the Central Bank of the open market policy, which is an important tool for the management of monetary policy. According to it, the central bank buys and sells government bonds in the stock market to influence the liquidity and interest rate structure.

According to several studies, there is a strong relationship between monetary policy and the level of stock prices in stock markets, which confirmed the existence of a positive relationship between the quantities of money offered on one side, and between each of the interest rate and the level of economic activity on the other side.

This relationship exists due to an increase in the resulting decline in interest rates and the money supply, which will encourage more investments leading to increased production and lower unemployment, that the level of demand for products and an

increase in production reflect it, that would increase profits, leading to increased stock prices in stock markets based on the rise of the money supply.

#### **2.5.15.4 Improving the Financial Situation of the Country**

The stock market can improve the financial situation of the country through the implementation of privatization programs; that will eventually reduce inflationary pressures on the public level. Then the companies would be able to improve their performance and contribute more effectively in the process of economic development. The increase in real economic activity leads to an increase in the proceeding of country taxes that contribute to the support of the financial situation of the country, which ultimately causes more implementation of privatization programs.

#### **2.5.15.5 Control Inflation and Modify Imbalanced Price**

The stock market can also contribute to the reduction of the level of inflation pressures by providing the liquidity and long-term financing, which would produce new investment opportunities and expansion of existing investments, which will increase the levels of growth rates of the entire supply of the goods and services.

#### **2.5.15.6 Improve Corporate Performance and Disclosure of Accounting**

The stock market can play important roles in providing medium and long-term finance, and also in the area of optimal allocation of resources. The market can channel the resources into appropriate investments, according to their economic feasibility, which will lead to an increase of the number of companies and expansion of the existing ones, which will open the sites of new production to conduct more employment of labour and an increase in local output.

In the area of transparency and disclosure, the rules and regulations of governing the financial market works require that listed companies have to be committed to providing and achieve a number of requirements for disclosure of accounting. The most significant of these laws is the need to provide account information about the company's performance in specific times and uniformly with other listed companies in the market.

Moreover, the stock market also has a role in the field of good management and the concentration and control of ownership, accounting education policies, laws and decisions, privatization and expansion of the base of ownership and wealth distribution program. Besides, it can create a suitable environment of bond and share investment by encouraging saving and raising investment awareness, thereby improving the allocation of financing sources. Furthermore, it can augment economic growth, allowing the comparison of the investment opportunities, facilitating the privatization program. They transfer the ownership of economic public units, state-owned establishment and companies to the general public, facilitating the program of distributing wealth to the poor families in Libya. This measure helps in diversifying portfolios and more importantly converting shares to cash when required which attracts the foreign investment.

#### **2.5.16 The Libyan Stock Market Contribution in Support of the Libyan Economy**

The Libyan stock market is a developed market that emerged very recently, so it will need a long time to be a real and effective contribution normally. For this reason, the role of the market is still indirect.

On the other hand, the Libyan stock market has an indirect promotion role in the economic growth through the increase of the end year profits. For example, most of the companies and banks in LSM made profits at the end of the year. For example, the Libyan insurance company made a profit available for distribution for 2009 about LYD 9,019,895,586. Also, Sahara and the insurance company made a profit available for distribution for 2009 about LYD 2,151,822,886 that means that these profits became incomes to Libyan economy (LSM annual report, 2009).

#### **2.5.17 Foreign Investment Trading in the Libyan Stock Market**

Foreign investments are considered one of the most important injection factors in the stock markets in developed and developing markets of all countries. This type of investment was appeared in the Libyan stock market from 2008 during the trading of foreign securities on the Trade and Development Bank, Sahara Bank, Al-Wahda

Bank, Al-Gomhoryia Bank and the Libyan Insurance Company. However, this trade was simply because the market was new. Table 2.10 presents the foreign trading value in LSM in 2008-2009.

Table 2.10: Foreign Investors Trading Value in LSM in 2008 – 2009\*

Country	Trading Value (2008)	Trading percentage (from foreign investors)	Trading Value (2009)	Trading percentage (from foreign investors)
Egypt	120,336	39.77%	211,768,95	43.13%
Palestine	67,585	22.33%	174,395,82	30.02%
Algeria	0	0%	2,251,25	0.45%
Tunisia	44,685	14.77%	456,25	0.09%
Sudan	23,200	7.67%	0	0%
Jordan	2,968	0.98 %	0	0%
Syria	9,682	3.20%	0	0%
India	489	0.16%	507,50	0.10%
Italy	33,660,000	11.12%	128,128,99	26.10%
<b>Total</b>	<b>302,605,000</b>	<b>100%</b>	<b>490,508,76</b>	<b>100%</b>

Source: Annual reports of the Libyan stock market (2008-2009)

\*There is no available information about foreign trading in 2010 and the beginning of 2011

According to the table above, in 2008, Egypt has a bigger value of trading which reached LYD 120,336,000 while India has just LYD 489 its equal 0.16 percent of the foreign investors trading percentage. In 2009, Egypt still has the largest value of trading, but it increased to LYD 211,768,95 while the trading value of Tunisia was the lowest one, it was LYD 456,25.

Comparing among the two years trading value, the trading value was increased from LYD 302,605,000 in 2008 to LYD 490,508,76 in 2009. This situation indicates the increase of the contribution of foreign investors in LSM. During the study years, the LSM made three agreements for joint co-operation partnerships; these are: agreeing with Arab Society of Certified Accountants; London Stock Exchange and the University of Reading. These three issues will discuss next.

On October 2007, Jordan signed an agreement for joint co-operation between the Libyan stock market and the Arab Society of Certified Accountants (ASCA). The

policy of the convention within the Libyan stock market is rehabilitation and development of employee skills in accounting and auditing. It would improve their knowledge through examine and review updated methods of international accounting. The advertising for the LSM is available online under the framework of scientific programmes agreed.

On 15th October 2007, an agreement was signed in London for joint co-operation between the Libyan stock market and the London Stock Exchange (LSE) in the area of training and skills development for employees. The convention benefits from the long experience of LSE in this area for the rehabilitation of LSM care to do their duties to the fullest extent. In addition, they aim at reviewing the Libyan stock market rules and regulations and developing the commensurate changes required by each state. The convention additionally stipulates the need for participation of the Libyan side in each symposium and conference which will hold under the LSE supervision.

On 17th October 2007, the LSM signed a joint cooperation agreement with the University of Reading in the area of securities trading. According to this agreement, technical assistance and training will be provided in the two countries, Libya and Britain to market intermediaries and workers on the disclosure of financial data, arbitration and dispute resolution, governance and the preparation of legal rules and regulations. These would enhance the performance of censorship and hence protect the users. In addition to that, it will provide consultancy for the development of the financial markets (LSM annual report, 2007).

In 2008, the LSM organised many training programmes inside and outside Libya for its employees in a variety of stock market fields. One of these programmes was in Egypt and Bahrain. Other programmes include attending the international conferences and workshops such as the Federation of placement centres in Africa and the Middle East AMED, to improve its member's skills (LSM annual report, 2008).

The year 2009 witnessed many agreements and workshops such as, "Investment in capital markets and portfolio management and investment funds" workshop that did share with English reading university on 16-5-2009. In 18-05-2009, the LSM attended Arab stock markets meeting in London Stock Exchange LSE. In addition to that,

various training programmes were made for the market employees; brokerage company employees and sessions, raise public awareness of the importance of the stock market (LSM annual report, 2009). In 2010, the LSM continued to organize the training programs to improve its employee's skills, which affected positively on its performance.

## 2.6 CONCLUSION

In short, it shows that, Libyan economy is in need of the existence of the stock market, as there are many un-favourable factors which can hinder the development of the Libyan economy as discussed in the previous sections. Since the country is highly depended on the oil revenue, the development of financial and stock market could lessen the risk of the country from being too vulnerable to the change in the oil price. Recently, after the establishment of LSM, many improvements had been done by the market to make its role more prominent. However, there is still room for the market to improve the services offered so that they could attract both local and foreign investors.