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Determinants of financial development

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Abstract
This study focused on reviewing of literatures on the determinants of financial development. Areas covered in this research are but not limited to: The Determinants of Stock Market Development in the Middle-Eastern and North African Region, Developing a Financial Services Planning Profession in the UK: An Examination of Past and Present Developments, Terrorism Financing and the Threat to Financial Institutions, Behavioural Finance: The Role of Psychological Factors in Financial Decisions, Corporate Financial Policies in Emerging Markets: The Role of Financial Market Development, Linkages between Investment Flows and Financial Development: Causality Evidence From Selected African Countries, Financial Integration in Selected South Asian Countries, The Financing Behaviour of Firms and Financial Crisis, The Determinants of Financial Development: New Evidence from the Middle East And North Africa Region, Entrepreneurship Development And Financial Literacy in Africa. The aim of this research is to review literatures on the above mentioned areas, thereby given rooms for researchers to further build on the existing literatures.

Keywords: financial market development, stock market, financial services, financial institutions, corporate financial policies, behavioural finance models, and financial crisis

1. Introduction

The researcher will be critically reviewing different scholarly works. Of which the researcher will be agreeing or disagreeing with the writers as well as making his own contributions as the work progresses.

Conducting any type of research project without conducting a literature review can be likened to travelling to a strange and exotic country but never coming out of your hotel room. How will you convince your friends back home that you truly sampled the delights of this exotic destination? Granted you may reach your destination, you may even achieve the occasional moment of insight but you will be starved of so many valuable moments of discovery. It may seem to an outsider that you have never even travelled at all! Without a literature review, you will not be able to understand your topic fully (Fink, 2005) [11]. You will not be able to identify what has already been researched and what remains to be explored, and you will deny yourself valuable insights into those methods that are or are not appropriate for investigation of your topic. You will not only face the danger of reinventing the wheel but, even more critically, you will run the risk of ‘reinventing the flat tyre’!

Recent years have witnessed a vivid interest in empirical research on the relationship between financial sector development and economic growth. The relationship was found to be bi-directional, that is financial development is crucial for economic growth and economic growth can also promote financial development (Omran, 2007) [54]. The evidence deals with this causal relationship along three lines:

- Financial development accelerates economic growth or is conducive to growth slowdowns. The financial sector increases savings and allocates them to more productive investments. Thereby financial development can spur economic growth.
- Economic growth promotes financial development. According to this hypothesis, financial development appears as a consequence of the overall economic expansion.
- The reciprocal relationship. Economic growth makes the development of financial system profitable and the establishment of an efficient financial sector contributes to stimulate economic development.

The financial system is essential to an economy because it is responsible for resource allocation. Well-working financial intermediaries may affect positively the economic development through four main channels which consist in reducing information and transactions costs, improving the allocation of resources (through fund pooling, risk diversification, liquidity management, screening and monitoring), increasing saving rates and promoting the development of markets and instruments that enable risk sharing organic relationships between stock market development and economic growth are identified (Omran, 2007) [54].

2. The determinants of stock market development in the middle eastern and North African (mena) region

The purpose of this study is to investigate the role of stock markets in economic growth and to shed some light on the macroeconomic determinants which must have an important influence on stock markets development. According to the researcher, in terms of a Nation’s economy, stock markets development can equally lead to Financial Development. In other words, macroeconomic determinants can also be

Determinants of Financial Development. In the article, some of the findings show that saving rate, financial intermediary, stock market liquidity and the stabilization variable are the important determinants of stock market development (Omran, 2007) [54], which can also be the determinants of financial development, according to the writer of this work. In retail financial services, the intangibility of financial services is further complicated as the consequences of decisions made today may not be known for many years (Ashton, 2008) [7]. The researcher agrees with the scholar on this. Most of the Middle-Eastern countries have engaged in implementing economic reform and structural adjustment programs in recent decades. The author seeks to investigate the fundamental determinants of the development of financial markets and carbon markets. However, the book further examines systematically the factors that might account for cross-country differences in financial development. It employs two modern quantitative methods, Bayesian Model Averaging (BMA) and General-to-specific (Gets) approaches, to gauge the robustness of a selection of possible determinants of financial development. Special emphasis has been placed on the contributions that institutions, policy and geography may have in developing financial markets (Yongfu, 2010) [74]. The core of the above mentioned programs is the reformed in the financial sector that have enabled most of MENA countries to establish or resurrect their stock markets. As a result, stock exchanges in these countries and other emerging economies became very important to the world's economy and their role in the international financial system witnessed a significant increase (Omran, 2007) [54].

3. Developing a financial services planning profession in the UK: an examination of past and present developments

Addressing information asymmetry, limited customer comprehension, potentially unsatisfactory financial advice and flawed personal financial decision making, has a central role in protecting the best interests of financial service customers (Ashton, 2008) [7]. Questioning whether the UK can develop a profession of personal financial planners addressing the related problems of information asymmetry, has wider significance for a number of reasons: Firstly, the functionality of social systems is contingent upon their ability to sustain the financial health of their citizens. In this sense, the financial services sector occupies a pivotal position as a mechanism for sustaining the health and equilibrium of society itself. Secondly, confidence in the integrity of the financial services industry is at low-ebb (Ashton, 2008) [7]. Recent empirical studies suggest that imperfect capital market and information asymmetry have influence on firm's ability to raise capital for investment (Abor, 2013) [1].

Key issues which arise relate to the following two questions (Ashton, 2008) [7]. They are: First, how can the financial services industry are organized to ensure that sales advisors are motivated to subjugate their own immediate self-interest in favour of the best interest of those they are supposed to serve? Second, how can customers be confident that advisors possess the necessary skills and competence, motivation and integrity, to act in a way that is consistent with securing the best possible outcome for their customers?

According to the researcher, if the two above questions are sincerely answered, it will help solve the problem of information asymmetry, which on the other hand will lead to financial development when the financial services planning profession is well developed.

4. Terrorism financing and the threat to financial institutions

This paper examines CFT and the impact on financial institutions. Combating or Countering the Financing of Terrorism (CFT) involves finding relatively small sums in an ocean of money. The Code provides for a ministerial exception whereby financial institutions will be permitted to continue operating the account. Of course, anyone who has worked in government knows getting a Minister of the Crown to sign a comfort letter in the world of real-time investigations is never going to be easy or happen quickly. Any self-respecting listed terrorist will not transact financially in his or her own name. Someone who will kill innocent civilians will be supine about identity theft to evade the list. Finally, the UN list focuses on Al-Qaeda and the Taliban, not reaching Sikh militants, Tamil Tigers and the like (Simser, 2011) [59]. Financial services suppliers can exploit this lack of understanding in a number of regards. These concerns are illustrated through considering issues of credence goods, agency problems, and information asymmetry (Ashton, 2008) [7]. Over the past three decades, it has been undeniably observed that the financial sector of many successfully developed countries have always played a crucial role in economic growth because the financial sector is able to contribute to economic development through accumulating capital and redirecting aggregate savings into financing productive investments. The financial sector has also been considered a fundamental building block for a healthy and well-diversified economy. The failure of one of its components (e.g., banks, markets, other financial institutions) can spill over to the entire sector and harm the real economy. For example, the financial crises in some Southeast Asian countries in 1997, the Russian Federation in 1998, Turkey in 2001, and the recent global financial crisis, are all marked with the failure of the financial sector. Likewise, a successfully effective and efficient, sophisticated, wise and well-managed financial sector will be a great national boon. This will allow that country to transform itself into a modern and developed society standing out among its peers. As financial sector's structure is expected to reflect the production's structure (Lin *et al.*, 2009) [47], we presume that the financial sector in a resource-dependent economy like Yemen is shaped by the extraction sector (Kurronen, 2015) [44]. A CFT regime that treats terrorist organizations as uniform and static entities is bound to fail (Simser, 2011) [59].

According to the researcher's opinion, when terrorism financing stops, the threat to financial institutions will seize. And all these will lead to the county's economic growth as well as improvements in its financial development.

5. Behavioural finance: the role of psychological factors in finacial decisions

"Behavioral finance models are usually developed to explain investor behaviour or market anomalies when rational models provide no sufficient explanations". They found that finance

professionals were more over confident than novices but that they could reduce this bias if they were given feedback. Clearly, experience does not always produce expertise. Furthermore, lay people now have increasing access to stock markets via the internet (Harvey, 2012) [30]. While financial institutions can rely on private sector databases like World-Check, one wonders how that interfaces with the court challenges that we have seen in Europe and might reasonable expect to see in countries like Canada (Simser, 2011) [59]. The researcher advises that it is very dangerous for a person to take financial decisions when he is not in the right state of mind. The researcher went further to say that in order to experience financial development; the psychological factors in financial decisions must all be available and actively functioning. PCA is a standard tool in modern data analysis to extract relevant information from confusing datasets. With minimal effort, PCA provides a roadmap concerning how to reduce a complex dataset to a lower dimension to reveal the sometimes hidden, simplified structures that often underlie it (Shlens, 2014; Ang and McKibbin (2007) [58, 6].

6. Corporate financial policies in emerging markets: the role of financial market development

This paper examines the impact of financial market development on the financial policies of firms in emerging markets. It investigates how financial markets affect the firms' decision to either retain capital for investment or rely on external finance for their operations. More specifically, we examine how the development of stock and bond markets affects the importance of debt relative to equity and external finance relative to internal finance in the balance sheets of emerging market firms (Abor, 2013) [1]. The measurement of stock market development is important because it is the precept for predicting economic growth and therefore, the principle for country selection by foreign investors (Omran, 2007) [54]. The analysis shows that stock market development is associate the higher use of external finances relative to internal finance, while bond market development is associated with lower use of external finance relative to internal finance. The findings of this study also indicate that stock market development tends to shift the policies of firms towards less debt and more equity, and bond market development is associated with higher debt and less equity in emerging economies (Abor, 2013) [1]. Accordingly, SAARC countries, which underwent the financial liberalization process and experienced a subsequent surge in trade and capital flows, provide an appropriate context to examine financial integration (Wickramanayake, 2012) [63]. According to the researcher, the role of financial market development can lead to financial development.

7. Linkages between investment flows and financial development: causality evidence from selected African countries

The purpose of this paper is to introduce previously missing financial components (efficiency, activity and size) in the assessment of the finance-investment nexus. The three main findings that were established here are: first, while finance led investment elasticity is positive, investment elasticity of finance are negative: second, but for Guinea Bissau, Mozambique and Togo, finance does not seem to engender portfolio investment: and finally, contrary to mainstream literature, financial efficiency appears to impact investment more than financial depth (Asongu, 2014) [8]. Guiso *et al.* (2000) [29] discussed the significant role of social capital on financial development. In areas of the country with high levels of social trust, households invest less in cash and more in stock, use more checks, have higher access to institutional credit, and make less use of informal credit. In these areas, firms also have more access to credit and are more likely to have multiple shareholders. The four policy implications results are:

First, extreme caution is needed in the use of single equation analysis for economic forecasts;

Second, Financial Development leads more to investment flows than the other way round;

Third, financial allocation efficiency is more relevant as means to attracting investment flows than financial depth; and

Finally, the somewhat heterogeneous character of the findings is also point to shortcomings in blanket policies that are not contingent on country-specific trends in the finance-investment nexus (Asongu, 2014) [8]. The researcher sees Linkages between Investment Flows and Financial Development as twin partners that cannot be separated from each other. Public ownership in the banking sector can also have an impact on financial development. La Porta *et al.* (2002) and Andrianova *et al.* (2008) [4] suggested that state banks are inherently less efficient than private banks in terms of their lending and investment decisions.

8. Financial integration in selected south Asian countries

In the early 1990s, countries of the South Asian Association for Regional Co-operation (SAARC) adopted financial liberalization policies facilitating foreign capital inflows. Also, intra-regional trade activity had increased significantly in this region benefiting mainly from bilateral and multilateral trade agreements. At the same time, during the last decade, India emerged as an economic powerhouse and a financial hub. Moreover, although many financial markets in SAARC countries are at developing stages, there exists a greater potential to become a regional financial hub. In this context, researchers and financial analysts pay greater attention to financial markets in these countries. Particularly, with the changes in financial architecture and far-reaching reforms embarked since 1990s in the SAARC region, it is believed that financial markets in these countries are integrated to a greater extent (Wickramanayake, 2012) [63]. Over the past three decades, the financial repression and financial development framework proposed by McKinnon (1973) [48] and Shaw (1973) [57] has been the main intellectual basis of financial market analysis and policy advice. Before the 1970s most developing countries had been financially repressed in the sense that their financial systems had imposed upon them discriminatory taxation in the form of low interest rate policies, high reserve requirements and high inflation rates. Keynes (1936) and Tobin (1956) are among the various justifications for maintaining these policies. The McKinnon-Shaw model of financial repression formulates the phenomenon of financial repression and points out that financial repression reduces both the quantity and quality of

aggregate investment in the economy in the sense that a lower deposit rate of interest discourages households from holding deposits that would be used to finance productive investment. However, in reality, assets do not have sufficiently similar characteristics and hence, it is required to take into account differences in systematic risk factors and other important characteristics. Moreover, although complete integration is not observed frequently, some form of integration can be observed across financial markets through several measures and indicators. There exist three broad categories of measures and indicators, which can be used to gauge the level and the extent of integration amongst financial markets, namely, price-based indicators, quantity-based indicators and regulatory and institutional measures (Wickramanayake, 2012) [63]. In addition to the above these researchers wrote on firm performance (Nwokwu, Dharmadasa, and Rathnasingha, 2018; Nwokwu, Rathnasingha and Pradeep, 2019) [52, 51]. From the researcher's opinion, financial integration can lead to financial synergy; this on the other hand will bring about financial development.

9. The financial behaviour of firms and financial crisis

The role of financial elements that drive the operations of firms (Adomako, 2014) in the irrelevance theory, M & M argued that in a perfect market, how a firm is financed is irrelevant to its value. Debt is therefore used as a device for controlling free cash that cannot be profitably invested in the company. While it is clear that financial depth has a positive effect on economic growth, the questions of what determines financial development and how to develop financial markets remain imperfectly understood. More specifically, economists still have an insufficient understanding of the following key issues. What brings about the emergence and development of financial markets? What are the reasons why different financial structures, bank-based or market-based, exist in countries where similar levels of economic development have been reached? What accounts for the differences in the levels of financial development in countries like the OECD member countries which have similar income levels, and geographic conditions? The world witnessed the worst financial crisis and climate crisis of our age during the period 2007–09. This highlights the significance of the research into what is essential to the development of financial markets and what is key to develop carbon markets for tackling climate change (Yongfu, 2010) [74]. Profitability is negatively related to leverage (Adomako, 2014). From the researcher's point of view, if there are financial crisis, it will definitely affect the financial Development in one way or the other.

10. The determinants of financial development: new evidence from the Middle East and North Africa region

The empirical results based on the Fully Modified Ordinary Least Squares (FMOLS) method indicate that financial development is affected by economic growth, trade openness, bank concentration, institutional quality and the government ownership of banks, while the findings from the dynamic ordinary least squares (DOLS) technique only support trade openness and bank concentration as promoting financial development. The countries of the Middle East and North Africa (MENA) region have implemented economic reforms and structural adjustment programs over the last few decades. There is an expectation that a dominant role played by government through implementing financial market policies and financial reform programs can affect the development of financial markets and cause economic growth. Thus, a careful analysis of the sources of financial development can provide additional evidence which is particularly important for policy makers in this region (Falahaty and Hook, 2015) [10]. While institutions are at the top of the list of the most often cited determinants of financial development, Law and Habibullah (2009) added to the institutional quality the importance of trade openness and financial liberalization. According to the authors, when a country is open to trade and capital flows, it is more likely to develop its financial system due to its role in promoting competitive markets (see also, Baltagi *et al.*, 2009; Huang and Temple, 2005; Kim *et al.*, 2010; Svaleryd and Vlachos, 2002) [9, 33, 43, 61].

Indeed, their framework suggests that interest rate controls may distort the economy in several ways. First, it may discourage entrepreneurs from investing in high risk projects despite them being potentially high-yielding investments. Second, financial intermediaries may become more risk averse and practice preferential lending to established borrowers. Third, borrowers who obtain their funds at relatively low costs may prefer to invest in only capital intensive projects. Hence, they propose that financial liberalization and less government intervention in controlling and imposing ceilings on interest rates can increase financial development. They also use the ratio of nominal liquid liabilities to nominal GDP as a financial development measure (Falahaty and Hook, 2015) [10]. To add to the above, this researcher also conducted research on financial performance measure (Nwokwu, Atapattu, & Azeez, 2019; Nwokwu, 2018) [52, 53]. They find that countries with poor political institutions exhibit greater financial instability, even though they tend to have restrictive regulations on competition in the financial sector (Falahaty and Hook, 2015) [10]. The results also show that infrastructure development and the degree of openness of an economy are the most robust indicators for the development and effective functioning of financial markets in the MENA region. The researcher agrees with the writers of this article on their points.

11. Entrepreneurship development and financial literacy in Africa

The practical implication results show that the difficulties in access to finance, access to market, policy support and entrepreneurship culture are the main problems and constraints on entrepreneurship development in Africa which has a very strong implication for financial literacy on the continent particularly on micro, small and medium enterprises (Abubakar, 2015) [2]. The opinion of the researcher is that when entrepreneurship development is well stabilized and financial literacy is well strengthened, all these will lead to economic growth as well as financial development. These authors also wrote on economic growth (Munasinghe, Attapattu and Padmasiri, 2018) [49]. African governments and other development partners should re-evaluate their intervention programs to strengthen financial literacy, skills while simultaneously supporting entrepreneurship

development by promoting an entrepreneurship culture through the right policy that will actively simulate the development of entrepreneurs that will contribute to entrepreneurship ecosystems and ultimately enhance Africa's economic development (Abubakar, 2015) [2]. In terms of financial liberalization, the importance of this determinant is traced back to Stanford economists McKinnon (1973) [48] and Shaw (1973) [57] who argued that liberalizing the financial system, i.e. removing interest rate ceilings, reducing reserve requirements and abolishing priority lending, is critical in delivering financial development (see also Ang, 2008; Fischer and Valenzuela, 2013) [5, 12]. In conclusion, determinants of financial development can also lead to economic growth.

12. Areas for further research

Since this study mainly focused on reviewing of literatures, efforts should be made to conduct recent empirical study, comparison studies, as well as case study research.

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