Behavior Financial Theory and Analysis Of Investor Behavior In The Capital Markets In Lebanon

Zinah Najem Abd Ali[1], Akram M. ALhamad[2], Bilal Eneizan[3], Fathi Al-share[4]

[1,2]*Faculty of Business, Karabük University, Kastamonu Yolu Demir Çelik Kampüsü, 78050 Kılavuzlar/Karabük Merkez/Karabük, Turkey.*
[3,4] *Business school, Jadara University, Jordan*

Abstract: *This paper discussed the market emergence in the Middle and East generally and Lebanon specifically. Firstly, the main components of market emergence in Lebanon are considered, including the size, depth, activity, and transparency of the market, then proceed to a descriptive analysis. Aggregating these observations into four bootstrapped indexes, the factors leading to market emergence with a probity model have been addressed and highlighted. It is found that the market size and activity seem to affect market emergence, whereas pricing and transparency do not. Finally, decomposing country-level probabilities and implementing a cluster analysis suggest that the average process of market emergence is more pronounced in the Lebanon region than it is in other emerging areas, such as Latin America and Eastern Europe. Overall, the results suggest that the Lebanon capital markets may attract more capital flows in the future. However, the markets are still heterogeneous: Whereas Turkey, Jordan, and Egypt are moving closer to the standards of developed countries, Lebanon, Tunisia, and Morocco can still be viewed as frontier markets.*

Keywords: Market Size, Lebanon, Market Emergence, Capital Markets, Developed Countries, Pricing.

INTRODUCTION

This field of study argues that people are not nearly as rational as traditional finance theory makes out. For investors who are curious about how emotions and biases drive share prices, behavioral finance offers some interesting descriptions and explanations. Lebanon has a recent breakthrough in this field, as lately the prime minister started to encourage foreign investors to invest in the country in various economic fields [1].

Capital Markets Law 161 in Lebanon provides a good framework and clear definition for the responsibilities of the CMA and protects it from any interference, political or otherwise. According to this law, the CMA should, among other things, organize and develop capital markets in Lebanon [2]. It also promotes their use by investors and issuers in Lebanon and abroad, reduce systemic risks in capital markets, protect investors from illegal, irregular or unfair practices, organize the availability of information to those distributing financial instruments to the public, organize and supervise the professional activities of the people who perform operations on financial instruments [3]. However, the objectives of this paper are as follow:

- To study the concept of behavioral finance.
- To understand difference between traditional finance and behavioral finance.
- To analyze the utility of models of behavioral finance for better investments decisions.
- Study of behavioral economics for understanding concept of bounded rationality

The branch of economics, which is concerned with this paradox, is called behavioral finance. This relatively new field seeks to combine behavioral and cognitive psychological theory with conventional economic theory in order to propose explanations as to why people might make irrational financial decisions [4].

Trading strategies are methods that traders use to determine when to buy and sell assets in the financial markets. Strategies are based on technical analysis, fundamental analysis, quantitative methods, a combination of decision factors.

The Lebanese government approved the Capital Markets Law 161 in order to call for the establishment of the Lebanese Capital Markets Authority (CMA) that has two main aims delineating its mission: promoting and developing the Lebanese Capital Markets and protecting investors from fraudulent activities through issuing regulations that are in line with international best financial markets practices [5].

LITERATURE REVIEW

In view of the various questions of the classical financial theory or efficiency theory. Researchers in Lebanon were motivated to develop a new research stream that excludes some of the old hypotheses of this theory and perfectly illustrates the performance of the country's financial markets [6].

In this regard, the modern financial theory bent to privilege a new approach of the finance focused principally on the way of understanding, including or modeling the real behavior of the people of the finance and its impact on the functioning of financial markets [7].

Lebanon's economy follows a laissez-faire model. Most of the economy is dollarized, and the country has no restrictions on the movement of capital across its borders [8].

In the modern days, many firms choose the investment plan that maximizes the entrepreneur's intertemporal utility, given static expectations. It is shown that the rate of investment is closely related to the rate of profit retention. It is also demonstrated that the optimal plan can be approximated by a flexible accelerator model of investment [9]. If expectations prove wrong, the investment behavior of the firm could involve instantaneous debt and capital stock adjustment prior to the operation of the flexible accelerator [10]. It is very important to examine the herding behavior at the level of sectors by using data at the levels of companies in developed countries such as Lebanon. The primary role of the capital market in Lebanon is allocation of ownership of the economy's capital stock [11]. In general terms, the ideal is a market in which prices provide accurate signals for resource allocation: that is, a market in which firms can make production-investment decisions, and investors can choose among the securities that represent ownership of firms' activities under the assumption that security prices at any time "fully reflect" all available in- formation. A market in which prices always "fully reflect" available information is called "efficient" [12].

At present there is no theory describing the manner in which the price of risk results from the basic influences of investor preferences, the physical attributes of capital assets, etc [13]. Moreover, lacking such a theory, it is difficult to give any real meaning to the relationship between the price of a single asset and its risk [14].
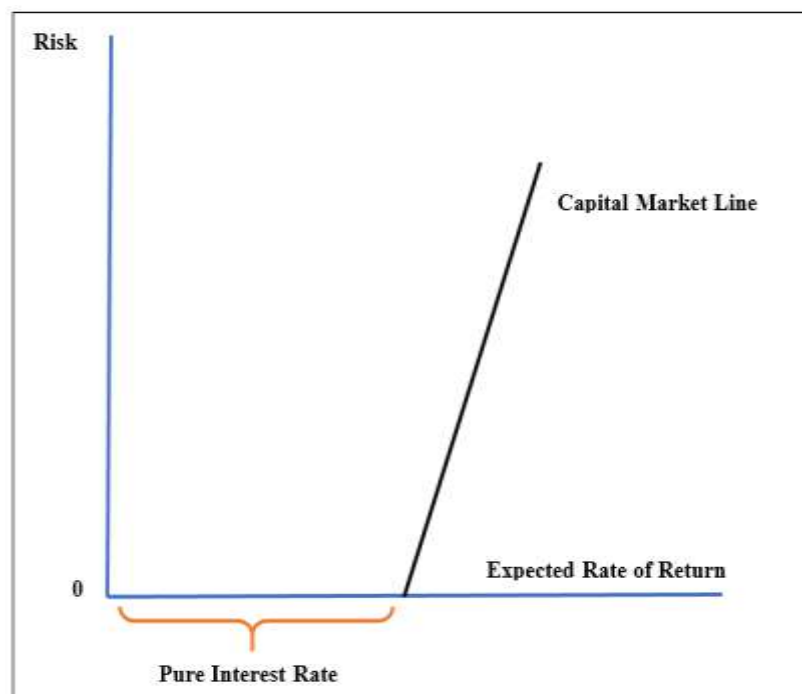

Figure 1: Relation between price and risk assist [15]

The model of investor behavior considers the investor as choosing from a set of investment opportunities that one which maximizes his utility [16] [17]. Every investment plan available to him may be represented by a point in the ER, σ_R plane [18] [19]. If all such plans involve some risk, the area composed of such points will have an appearance similar to that shown in Figure 2.
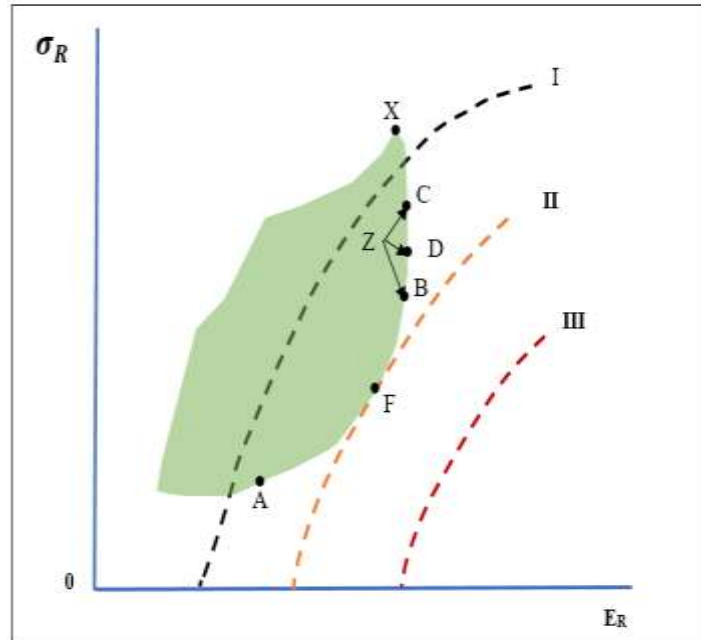
Figure 2: Investment Opportunity Curve [20]

Discussion

This is the descriptive type of research paper. In this paper attempt has been constituted to study and understand the concept of behavioral finance, and its benefits to investment decisions.

Together with a noticeable improvement in Lebanon's macroeconomic fundamentals, the improvement in its investment climate enabled Lebanon to attract much required investment as evidenced by an upward trend in FDI. Although some non-Arab capital – mainly European - was invested in infrastructure projects, the bulk of foreign capital channeled into the country originated from Arab countries. In fact, Arab FDI recorded a high of US\$500 million in 19991, before dropping to the US \$200 level in 2000 and 2001, amid an overall slowdown of the world economy as well as the aftershock of the events of September 11.

In 2002, Lebanon recorded a staggering increase in Arab FDI to US\$650 million, mainly stimulated by regained investors' confidence in Lebanon after the success of Paris II conference, where international donors pledged their support for the Lebanese government. Initial estimates for 2003 look promising despite the setbacks and the instability which dominated the region amid the war in Iraq, with Moody's Services predicting a sustained surge in FDI in Lebanon, with ratio of FDI to GDP rising from 1.7% in 2002 to an estimated 3.3% in 2003 and 4.2% in 2004.

Lebanon's public finance conditions are also an overriding concern to investors. In 2003, the government was able to reschedule 32% of the public debt through a \$10 billion financial package that included soft loans from donor countries after the Paris II meeting, a \$3.6 billion agreement with commercial banks and a \$4.1 billion scheme with the Central Bank. The outlook for 2004 looks good despite the fact that the privatization plan requires more government preparation and the public finance conditions stand to benefit from the full impact of Paris II. However, the BDL's FX reserves, which increased to a high of US\$12 billion, should play an important role in maintaining monetary stability, and reassuring investors of the strength of the Lebanese economy.

While Lebanon has made important strides in structural reform, the promotion of FDI is still lagging behind, and forecasted amounts of foreign investment do not meet the growth requirements of the Lebanese economy. Lebanon has relied, so far, on short term investments but failed to attract longer-term more stable and beneficial international capital. The challenges facing Lebanon revolve around four angles which are:

- Governance
- Public Finance
- Perception
- Geopolitical Conditions.

In addition, Lebanon's current perception in investment circles has been somewhat obscured by misconceptions of what it can offer to investors. The Lebanese government has been and is currently exerting all efforts to showcase Lebanon and raise awareness about the virtues and the attributes of the business environment. However, many businesspeople in Europe and North America seldom realize the business opportunities for investment in Lebanon. To market Lebanon, IDAL is not sparing an opportunity to enhance its visibility within investment circles - regionally and internationally, and most of all to put behind its image of a war-racked country. Meanwhile and in line with government's efforts to promote Lebanon, an advertising campaign – commissioned by the Ministry of Economy and Trade - publicizing the country as a tourist destination is being aired on CNN as of this month. On the other hand, investors also highlight regional stability as an important stumbling block before investing in Lebanon. This problem is not exclusive to Lebanon. The region has had a history of volatility – which has dampened investment. Caught in the middle of different conflicts, Lebanon has paid a high price for the region's instability in the form of lost investment opportunities.

Lebanon is disseminating the message, making sure that foreign investors are aware of investment opportunities in the country. Many other countries in the region are taking similar measures.

However, the entire region deserves better reputation than the one currently dominating the international business arena. This is where regional cooperation comes into play. Since we all share similar objectives and face common problems, there is a case for developing closer regional cooperation in the areas of investment policy and promotion. In addition, the initiative to create a network of IPAs in Arab countries launched last year can provide the momentum for such co-operation. All MENA countries stand to gain from improving the image of the region as an attractive investment destination.

Table 1: FDI and GDP in Lebanese investment

Factor	Year				
	1991	**2000-2001**	**2002**	**2003**	**2004**
*FDI	500 M	200 M	650 M	950 M	1 B
**GDP	-	-	1.7%	3.3%	4.2%
BDL	-	-	-	-	12 B
Reason	After the end of the Lebanese civil war and the return of life to normal, which led to the encouragement of Arab investors.	Because of the repercussions of September 11, which led to this noticeable decline.	Restore investor confidence in general, especially after the success of the Paris conference.	Increasing loans to investors while giving facilities based on the agreements concluded at the time.	With the increase in foreign currency reserves by 12 billion US dollars, this has led to an increase in the encouraging factors for investment.

*FDI: Foreign Direct Investment
** GDP: Gross domestic product
M: Million USD
B: Billion USD

CONCLUSION

Behavioral finance analyses the ways that people make financial decisions in Lebanon. Behavioral finance seeks to understand and predicts systematic financial market implications of psychological decision processes. In addition, it focused on the application of psychological and economic principles for the improvement of financial decision-making. Markets are assumed to be inefficient in behavioral finance in Lebanon. Stock market investments are prone to emotions and herd behavior, so the sudden fall or rises of stock market indices are common. In behavioral finance investors are normal and not rational, or intuitive so that they can take decisions about investments based upon company's performances, facts and profits.

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