

# **Religion and Cultural Dimensions of Trust in the Emerging Financial Market in Libya**

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**ABSTRACT:** A number of different factors affect stock market development in emerging markets. This paper addresses the role of culture and religion in the development of the Libyan stock market. In particular we examine the role of trust in the efficient operation of an emerging market and the importance of culture, religion and other variables in enhancing trust between market agents. The findings of this study are that both culture and religion have an important role in Libyan stock market development. Both culture and religion are dimensions that may lead to the enhancement of trust, which itself then *may* lead to successful financial market development in Libya.

**Keywords:** Religion; Culture; Trust; Libyan Stock Market.

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## **Introduction**

We argue in this paper that trust is an important mediating variable in stock market transacting and that cultural and religious factors can lead to the enhancement of trust. In this paper we investigate the cultural and religious factors that are likely to affect trust in the emerging Libyan market economy. We argue that without trust both the allocative and information efficiency of the market will be significantly impaired increasing contracting and other agency costs.

We commence by discussing the impact of culture upon markets before considering its role in forming trust based relationships. Finally we consider the role that religious practice and norms have both in the formation of trust - based relationships and in the development of the Libyan stock market.

## **Culture**

Culture is an important factor affecting the development of financial markets. Culture can be defined as “collective programming of the mind; it manifests itself not only in values, but in more superficial ways: in symbols, heroes, and rituals” (Hofstede, 1984, p.21). As a complex concept, culture has previously been defined in many ways. The following three definitions illustrate the complexity of definition borne by the term:

Kluckhohn (1951, cited in Hofstede, 2001, p.9) argues that “Culture consists in patterned ways of thinking, feeling and reacting, acquired and transmitted mainly by symbols, constituting the distinctive achievements of human groups, including their embodiments in artefacts; the essential core of culture consists of traditional (i.e historically derived and selected) ideas and especially their attached values”.

Hall (1969, cited in Abubaker, 2008) states that “Culture is the way of life of people; It is the sum of their learned behaviour patterns, attitudes, and material things”.

“Culture is the belief system and value orientations that influences customers, norms, practices, and social institutions, including psychological processes (language, care taking practice, media and educational systems) and organizations (media, educational system)”(The American Psychological Association, 2002).

Hofstede (2001) explains how *national* culture affects the values of the organizations in society. He examined the approach of employees in IBM branches in fifty countries (including Libya). On the basis of his analysis of national culture, he defined four dimensions as follows:

### ***High versus low power distance***

This dimension illustrates “the extent which the less powerful members of organization and institution accept that power is distributed unequally”. Organizations from high power distance cultures rely deeply on hierarchy.

### ***Individualism versus collectivism***

Individualism refers to societies in which everybody is expected to look after themselves and his/her immediate family. However collectivism illustrates societies in which people from

birth onwards are integrated into strong, cohesive in-groups, often extended families who offer protection and a degree of social insurance in exchange for unquestioning loyalty.

***Masculinity versus femininity***

This dimension describes the distribution of roles between genders. The masculine culture refers to the assertive pole and the feminine culture is referring to the modest caring pole. In feminine countries women and man share caring values, therefore they have the same modest approach. However, in the masculine countries there is a gap between men and women’s values. For instance, women are somewhat competitive and assertive, but not as much as men.

***Uncertainty avoidance***

Uncertainty avoidance cultures represent the extent to which members of a society respond to unstructured situations. In high uncertainty avoidance cultures people have lower tolerance for innovations, while in low uncertainty culture which has been called uncertainty accepting, people are more likely to accept different opinions from which they are used to.

According to Hofstede, Libyan culture is characterised by high power distance, low individualism, and high uncertainty avoidance. This description meant, in the context of his study of IBM, that all these dimensions negatively affected communication among employees in the corporate decision making process. However, he did not include the third dimension in his study - masculinity versus femininity - when describing Libyan culture. Abubaker (2008) however characterises Libyan culture as one with high power distance, low individualism, high uncertainty avoidance and masculine in nature. Twati in contrast (2006) found that Libyan culture retains strong power distance, uncertainty avoidance, and masculinity. Both differ from Hofstede’s earlier findings.

<b>Dimension</b>	<b>Hofstede (2001)</b>	<b>Twati (2006)</b>	<b>Abubaker (2008)</b>
<b>High power distance</b>	√	√	√
<b>Low Individualism</b>	√	-	√
<b>Masculinity</b>	-	√	√
<b>Uncertainty</b>	√	√	√

<b>avoidance</b>			
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Moreover, Hofstede suggests that the convergence between economic liberty and national culture is the one that creates positive effects for the business environment in general, and companies in particular. Herciu (2006) studied the influence of culture on economic freedom and the internationalization of business, and he found that there is no possible mixture of Hofstede’s cultural dimensions, which when applied, can assure a country’s development. Thus, each culture seems to have its own characteristics, which lead to various studies and approaches to communication. Therefore, there is no one cultural model that can assure success. Moreover, Hofstede suggests that the convergence between economic liberty and national culture can create positive effects for the business environment in general and companies in particular. Additionally, El-Kot (2007) cited in Abubaker (2008) notes that Hofstede has generalized the result of his sample of one company (IBM) to all companies in Arabic countries.

**Libyan Culture**

Libya is an Arabic country and the dominant religion is Islam. Libya shares a common language, religion, cultural values, and other social values with other Arabic countries. Vandewalle (2006 cited in Abubaker, 2008) claims that the impact of Islam upon Libyan cultural values is as significant as in any other Arabic country. Yousef (2001) says that according to the Islamic work ethic, social relations at work must rely on diligence, honesty, and respect for colleagues. Akbar (2003) sates that according to the Koran, God created people from different nations and tribes to know one another. Thus, Muslim people know the importance of good relationships with other people of other nationalities or religions. Twati (2006) pointed out that Libyan society has strong social, tribal and familial bonds. It is by its nature an intensely family oriented society.

In Libyan organizations, employees care about the reputation of their names, families and tribes, stemming from their strong family orientation. Social reputation becomes important for societal relationships in Libyan society (Twati, 2006). In Libyan culture most people unintentionally use facial expressions to express sadness, happiness, fear, and surprise (Twati, 2006). Therefore, the face saving strategy is one of the main approaches in Libyan communication.

Fukuyama (1996) argues that because unrelated people have no basis for trusting one another, family oriented societies typically have weak voluntary associations. This shows itself as relatively low levels of trust between unrelated (family) individuals. The state, he argues, must aid the development of large-scale businesses in such low trust societies by supporting them through subsidies, guidance, and even outright ownership. The cost will be state-owned companies that are inevitably less efficient and well managed than their private sector counterparts.

In Libya centrally planned communist public systems are adopted in many sectors, such as business, health, education, media, and other social and political organizations (Abubaker, 2008). However, organizational success in developed countries leads many organizations in developing countries to adopt Western models without considering local cultural values. This is the case with Libya. This leads to conflict between organizational values and national values (Al-Hamadi, Budhwar & Shipton, 2007). Therefore, the allure of globalization has affected most organizations in Libya. It has also created huge debate about organizational values and the methods of dealing with social issues in Libyan organizations.

### **Organizational culture**

Organizational culture can be defined as “the values, attitudes, beliefs and behaviours that represent an organization’s working environment, organizational objective, and vision” (Hofstede, 1984). Kluckhohn & Strodtbeck (1996) argue that organizational culture contains a mixture of practices or artefacts, beliefs and values and hidden assumptions that organizational members have in common about suitable behaviour. Also, Krumbholz & Maiden (2000) agree that organizational culture has been seen as holistic, traditionally decided, and socially built. Culture involves values, beliefs and behaviour, lives at a different levels, and is apparent in a wide range of characteristics of organizational life.

As such, organizational culture indicates a set of shared belief, values, practices and assumptions that form and guide members’ attitudes and behaviour in the organization (Hofstede, 1991, 1994, 2001). However, as Munro et al (1997) and Fey & Beamish (2001) point out, there has been a relatively shorter history of studies considering organizational culture that take a

cultural perspective in organizations. Such studies only began to appear in the late 1970s and early 1980s.

In addition, Cameron and Quinn, (1999) suggest that many of the managerial failures to implement planned organizational change occur because of the neglect of the culture of the organisation concerned. Schneider (2000) develop this point claiming that organizational culture is a key to organizational success, and effective leadership is the means by which culture is created and managed. An important activity for managers is to understand organizational culture because it affects productivity, strategic development, and learning at all levels of management.

Further research by Cameron and Quinn, (1999) suggest that organizations dominated by a hierarchical culture present a structured and formalized workplace, managed by formal rules, procedures and policies, with efficiency-minded leaders valuing smooth organization and coordination, and where stability, predictability, dependability, and employment security are highlighted. Twati (2006) notes that the public sector and the government themselves share the same attitudes, beliefs, and values.

Drawing on Fukuyama (2000), one could argue that the information age has led to a breakdown in hierarchy and authority. In principle, formal hierarchies reduce transaction costs by reducing the number of effective command and control relationships required to achieve given organizational outcomes (Williamson, (1967). They are less information rich and less dependent upon trust than other forms of organization design. The degree of trust and social capital in the broader society are the determinants of the ability of companies to move from formal and extensive hierarchies to flexible networks of smaller firms. Fukuyama (2000) argues that trust is not necessary for cooperation; legal mechanisms like contracts and self-interest together can compensate for an absence of trust and allow strangers jointly to create an organization that will work towards a common purpose and hence minimize the costs of transacting. He also argues that contract and self-interest are important sources for organizations but the most effective organizations rely on communities of shared ethical values which do not require wide legal regulation and contract of their relations due the basis for mutual trust. The same point was made by Ouchi (1980) and is expressed by Marshal (2000) who said that “*without trust we may give up hope*”.

The 1990's was a decade of chaos and fear, a time when major structural changes and massive layoffs resulted in broken covenants, lost loyalty, and distrust. To have a successful organization, the workforce should be trusted, respected, and given an opportunity to learn and grow, to contribute, to win, and to be acknowledged (Marshall, 2000). He goes on to claim that trust comes from the inside and goes to the outside. The development of 'trust competence' is perhaps the most critical challenge we face as individuals, teams, and organizations. If we are trustworthy, others will trust us. With trust, teams will exceed expectations, risks will be taken, and breakthroughs in operating efficiencies will occur. Speed will be achieved. When the risk in a situation is greater than the trust a control system can bridge the difference by lowering the perceived risk to a level that can be managed by trust. However, if there is a very strong system of controls in an organization, it will inhibit the development of trust (Fukuyama, 1996).

Distrust in a society imposes on all forms of economic activity a pernicious tax that is absent in high trust societies. The prevalence of trust does not facilitate the growth of large-scale organizations. Indeed quite the reverse – trust enables productive relationships to emerge that do not require formal contracting to achieve their outcomes. Trust, supported by modern information systems and technology can enable large hierarchies to evolve into networks of smaller companies (Marshall, 2000), and by so doing break the dominance of managerialism, bureaucracy and surveillance, which are characteristic of the absence of trust.

Fukuyama (1996) argues that in the early stage of economic development, firm size and scale do not appear to have serious consequences for society's ability to grow and prosper. Small firms are easier to establish, more flexible and adjust more quickly to changing markets than large corporations. However, certain sectors of the global economy are affected by the size of companies. Large firms are necessary to create the marketing organization that stand behind brand names. Moreover, Fukuyama suggests that social capital needs to be factored into a nation's resource endowment. A society with a high level of trust can organize its workplace on a more flexible and group-oriented basis, with more responsibility delegated to lower levels of the organization, while low-trust society must constrain their workers with a series of bureaucratic rules. He argues that social capital is the crucible of trust and critical to the health of an economy that rests on cultural roots. Moreover, to survive in the global market, businesses must be able to

increase efficiency and lower costs that depend upon an evolution from a culture of fear to one of trust (Marshall, 2000).

### **Stock Markets and Trust**

In the development of stock markets, trust has often been recognized as significant to its operation. A clear example of this is the motto of the London stock exchange ‘Dictum meum pactum’ officially adopted in 1923 it means that ‘My word is my bond’ ([www.londonstockexchange.com](http://www.londonstockexchange.com)). In many transition economies, the issue of ‘trust’ in relation to the development of stock markets has been of importance, for example Taiwan, Hong Kong, France, and Italy (Fukuyama, 1996). As Friedman (2007, cited in Covey, 2008) says:

*“Without trust, there is no open society, because there are not enough police to patrol every opening in an open society. Without trust, there can also be no flat world, because it is trust that allows us to take down walls, remove barriers, and eliminate friction at borders, trust is essential for a flat world...”* (p21).

Stock markets – as secondary capital markets – have a particular place in the efficient operation of capital based economies. In order to efficiently allocate capital resources between users, the capital market must be technically ‘perfectly competitive’, which entails *inter alia* zero transaction costs and zero barriers of entry and exit. However, in such markets where very high volumes of transactions occur on a daily basis, market mechanisms for managing default risk between counterparties must also be highly efficient. In situations of high trust market transacting can occur through oral commitments rather than being evidenced (and as in the transfer of real estate), noted and sealed. Without the ability to engage in oral contracting the cost burden of transacting would be deadweight on the efficiency of the market and sufficient in practice to remove the advantages market mechanism in favour of alternative methods of resource allocation.

### **The definition of trust**

Covey (2008) asserts that “you know trust when you feel it”. At its simplest the word ‘trust’ means ‘confidence’ and the opposite of trust is distrust or ‘suspicion’ (p5). Experience, however, tells us that trust is also a principle or an inherent quality in the character of individuals, teams,

and the workplace. It is shown in how people treat others, in how they conduct their work, and in how businesses treat their customers (Marshall, 2000). Just as with culture, there are many definitions of trust. For example:

Marshall (2000), uses Webster's definitions of trust as follows:

- *Assured reliance on the character, ability, strength, or truth of someone or something.*
- *One in whom confidence is placed.*
- *A charge or duty imposed in faith or confidence, or as a condition of some relationship.*
- *Something committed or entrusted to one, to be used or cared for in the interest of another (p47).*

*“Trust is a core psychological and interpersonal issue. Trust building activities help people to develop mutual respect, openness, understanding, and empathy, as well as helping to develop communication and teamwork skills”* (Neill, 2009, online at <http://wilderdom.com/games/TrustBuildingActivitiesAbout.html>).

Guiso (2007) argues that people care about trust because, its presence or absence can have an effect on what we *choose* to do and what we *can* do. Also, he points out that there are two concepts of trust. First, ‘personalized trust’ which means the trust placed in someone or something well known to the individual. Second, ‘generalized’ trust which is that given to a person who is unknown, but s/he is a member of a well identified community.

Laszlo Zslnai (2004) cites Sako (1992), who explained trust as a state of mind or anticipation held by an economic agent about another, that the other responds or behaves in an expected and mutually acceptable manner. Also, Zslnai (2004) distinguishes between three different kinds of trust. “The first kind of trust is called *contractual trust* which is based on the expectation that by written or oral agreements parties upholding a universal ethical standard, keeping a promise. A second type of trust is that where an individual expects a partner to work competently, hence

*competence trust*. A third type of trust refers to expectations of open commitment to each other. This trust in open commitment is labelled *good will trust*".

Guiso, (2007) argues that the lack of trust may lead to first order losses, although he points out four factors that influence trust:

- Religious beliefs of the trusting person affect how much a person trusts another.
- The social behaviour of the area where individuals were born.
- Social psychology shows that individuals trust more people who have a similar ethnic background to themselves.

Marshal (2000) argues that, trusting another reflects our confidence in their character, our faith in their capacities, and our dependence on their taking care of something that is important to us. Trust needs to be thought of in at least three ways:

**First**, it is a principle expression of what we value most in ourselves and others, and it is a frame of reference or way of looking at things.

**Second**, trust is a measure of our self-esteem-that is how we feel about ourselves. Without trust, we may give up hope.

**Third**, trust comes from the inside out. We must first be trustworthy, which means clarifying our values.

Covey (2008), argues that, as a global society, we have a crisis of trust on our hands: low trust is everywhere, it permeates our personal lives, our relationships, our organizations, our market place, our global society. A recent Harris Poll (2005, cited in Covey, 2008) states that in the United States 22% of those surveyed tend to trust the media, 8% trust political parties, 27% trust the government, and only 12% trust big companies. According to Covey (2008), "David Halpern found that only 34% of Americans believe that other people can be trusted. In Latin America, the number is only 23%, and in Africa the figure is 18%. Halpern's research also shows that, four decades ago in Great Britain, 60% of the population believed other people could be trusted; today it's to 29%. However, 68% of Scandinavians (Denmark, Sweden, and Norway) and 60% of the people in the Netherlands believes others can be trusted, which indicated that, those

are countries are higher-trust societies. Also he found that Mexico's figure, though a low percentage 31%, but it is up from 19% in 1983, which means that it is possible to increase societal trust. The same study found that trust within organizations has also declined. It showed that, about 51% of employees have trust and confidence in senior management, 36% of employees believe their leaders act with honesty and integrity, over the past 12 months of his study, 76% of employees have observed illegal or unethical behaviour on the job conduct which, if exposed, would seriously go against the public trust”(p11).

Covey (2008) argues that trust usually affects two outcomes: speed and cost. When trust goes down, speed will also go down and costs will go up, and vice versa. As John Whitney (1994, cited in Covey, 2008) says “*Mistrust doubles the cost of doing business* (p18).

Covey (2008) argues that trust is one of the most powerful forms of motivation and encouragement. People respond to trust, they want to be trusted, and they flourish on being trusted. Trust is a function of two things: competence and character. Competence includes capabilities, skills, results, and track record. Character includes honesty, motivation, and intention with people, and both are crucial. The common view of trust as expressed through capabilities is fast becoming the price of entry in the new global economy, because of the increasing focus on ethics in society. However, the differentiating and often ignored side of trust, competence, is equally fundamental. People trust that, those who have skills make things happen. Trust is equal parts character and competences; both are absolutely necessary. The increasing worry about ethics has been good for society. Ethics, which is part of character, is foundational to trust, but by itself is insufficient. Trust cannot appear without ethics, but ethics can be viewed without trust. Trust, which includes ethics, is the bigger idea.

Covey (2008), established a model he calls “5 Waves of Trust” which defines five levels, which help establish trust as follows:

### **1- Self Trust**

This first wave deals with the confidence we have in ourselves, and in our skills to set and achieve goals to keep commitments, and also that with our ability we can encourage trust in others. The main idea is to become, both to ourselves and to others, a person who is worthy of

trust. The outcome of good character and high competence is judgment, credibility, and influence.

## **2- Relationship Trust**

This wave deals with how to establish and increase the “trust accounts” we have with others. The whole idea underlying this wave is “consistent behaviour”. The consequence is a significantly increased the ability to create trust between all involved, in order to enhance relationships and achieve better results.

## **3- Organizational Trust**

Organizational trust explain how leaders can create trust in all kinds of organization, including government entities, businesses, not for profit organizations, , educational institutions, and families, as well as in terms of micro-units within organizations. The main point underlying this wave, alignment, helps leaders create structures, systems, and symbols of organizational trust that decrease or eliminate costly organizational trust taxes, and create organizational trust dividends.

## **4- Market Trust**

Market trust, explains the level at which almost everyone clearly understands the impact of trust. The underlying opinion behind this wave is “reputation”. It is about company brand as well as personal brand, which reflects the trust investors, customers, and others in the marketplace have. Brands strongly affect customer behaviour and loyalty became they are trusted. With a high-trust brand, customers buy more, refer more, stay you longer, and give up doubt. This helps not only improve brand and reputation as an individual; it also helps improve an organization’s brand and reputation in the marketplace.

## **5- Social Trust**

Societal trust deals with creating value for others and for society at large. The key principle underlying social trust is contribution. By contributing, suspicion is decreased low-trust inheritance taxes within society. This also encourages others to create value and contribute as well.

Tyler (2003) argues that the key issue which enables co-operation is trust. Tyler (2003) says that “trust is a key to organizational performance because it enables voluntary cooperation. This form of cooperation becomes increasingly important when command and control styles of management are no longer effective” (p 544). Similarly, Bijlsma and Koopman (2003) argue that hierarchical relationships are used to govern the framework of relations. Further, organizational performance becomes more and more dependent on behaviors such as contribution to organizational learning processes and helping colleagues to develop their performance, scanning the environment to discover opportunities. In addition, Creed and Miles, (1996 cited in Bijlsma and Koopman, 2003) note that trust and control both contribute to the level of cooperation needed in a relationship. For that reason, they should be seen as complementary phenomena.

In addition, Tyler (2003) points out that the multilevel hierarchies, which facilitate traditional command and control, are often flattened. So people will be more likely to work as teams of equals, without designation of a leader. Instead of this, group members’ responsibilities are shared, and ‘leadership’ may be different for varying responsibilities. Also, Tyler & Blader, (2000, cited in Tyler, 2003) state intellectual labours are not easy to monitor, and they rely heavily on willing engagement in work. So, since it is harder to monitor their behavior the leader must trust that workers are making an effort to work well, to shift increasing attention to extra-role behavior, the voluntary behaviors that workers perform in work settings.

Moreover, Tyler (2003) says that the key issue of social control is the informal relationships of family and friends that has a power to embed people in their social groups. However, traditional social control mechanisms are being lost because the network of extended family and long-term work associates is becoming weaker, since people are more separate from others, more mobile, and they do not think a their relationships as necessarily continuing over time. Additionally, Guinnane (2005) argues that, the family trust structure is useful if your family holds capital growth or income-generating assets. Tyler and Lind (1988); Tyler et al (1997); Tyler and Smith (1997) all cited in Tyler (2003) suggest that the two aspects of social motives whether internal or socially generated, are trust and procedural justice. They run from inside the person, rather than being related to incentives or sanctions. Social trust is based on attributions about the motives of others. People deduce whether they trust that others who have motivated to be ethical and fair, and whether they have the intention to do what is good for them (Tyler, 2003).

Tyler (2003) argues that motive-based trust is important for extra-role behavior, positive attitudes, and acceptance of decisions made by superiors. Experience of motive-based trust that are found included shared social bonds, quality of treatment by management, understandable actions by management, and quality of managerial decision making.

Drawing on Luhmann (1988), trust is an attitude that allows for risk-taking; therefore trust is a solution for particular problems of risk in relations between people. Schoorman, Maye and Davis (2007) argue that trust would lead to risk taking in a relationship “willingness to take risk”, and the level of trust is an indication of the total of risk that individual is willing to take. A control system is an alternate mechanism for dealing with this risk in relationship. The existence of a very strong system of controls in an organization will tend to reduce the development of trust (Strickland, 1958 cited in Schoorman et al, 2007). Trust is influenced by past experience and chances of future connections, together related within organizations. Therefore, such behavior will enhance the expectations of others’ beneficial actions (Schoorman et al, 2007).

Williams (2001) cited in Schoorman et al (2007) states that affective responses influence how people evaluate their level of trust in another party which means trust also involves emotion. In the same way, Jones and George (1998, also cited in Schoorman et al, 2007) note that moods and emotions provide people with information on how they are experiencing trust.

## **Religion**

Religion is one of the most important aspects of cultures, which may affect the stock market. It plays a significant role in most societies. Max Weber (1905) was the first to identify the significant role that religion plays in social change (Guiso, Sapienzad, & Zingales, 2003). In general, religious beliefs are related to ‘good’ economic attitudes, where good is defined as encouraging higher per capita income and growth (Guiso et al, 2003). However, Usmani (2010) argues that although every dollar bears the statement “In God We Trust”, the modern economy is outside the domain of religion, and God is seen as irrelevant to economic activities.

Religion affects not just the personal life of the individual, but it is also affects different aspects of human social life, including the cultural, economic, and the political. The effects of religion on different aspects of society can be seen especially in Islamic countries, where a

Muslim as a person and as a member of society, has specific duties and responsibilities. Generally speaking, Islam affects all aspects of Muslims' lives in these societies (Nasrabadi, 2006).

There are many references in the Qur'an to good and proper behaviour. In the sections that follow, those statements are presented from a number of Qur'anic verses and also from the Hadith, where such advice appears. Arab people have had a long history with commerce even before Islam they were extensively involved in trading. The Prophet Mohammad (Peace Be Upon Him) himself was a trader before he was acknowledged as The Prophet. The rules of trading are discussed in the Qur'an many times. So, there has been a special relationship between Islam and commerce (Shaari, Russell & Frank, 1993). Furthermore, according to Nasrabadi (2006) Islam is linked to economics in two ways:

Firstly, this indicates that Islam has a set of rules about ownership, taxes, transactions, charities, inheritance, financial punishments, and the effect of wealth on proper behaviour.

Secondly, Islam demonstrates a relationship to economics through ethics and morality. A good example of this is that there are recommendations and rules, such as trust, justice, and charity as well as some prohibitions such as theft, mischief and corruption.

Generally, Islam encourages business, as the Qur'an states "God has made business lawful for you". Also the Prophet Mohammad (Peace Be Upon Him) told that nine out of ten livelihoods are from trade. Thus, Muslims are keen to trade according to Islamic principles, for example lawful (halal) and unlawful (haram) (Shaari, Russell & Frank, 1993).

Sadeghzadeh (1995, cited in Nasrabadi, 2006) states that, three different kinds of control mechanisms can be distinguished in Islam to ensure that Muslims perform their duties. The three mechanisms are:

- 1- **Self-control**; it comes through a Muslim recognizing himself or herself as a human, whose being is always in front of God at any time.
- 2- **Public control**, which encourages people to behave well, and help them avoid any bad deeds.

**3- Government control**, which demonstrates that managed social behaviour is an important duty of an Islamic government, so people do not become involved in incorrect actions and desist from incorrect behaviour.

According to these beliefs, when Muslims understand this control system they try to act according to God's requirements at all times and in all aspects of this life. They do this due to self-control and also due to the pressures of public and government control.

Islamic principles recognize three different kinds of ownership; private, public, and state. However, Sadeghzadeh (1995, cited in Nasrabadi, 2006) says that, there are specific obligations regarding private ownership in terms of acquisition, use, and removal of property based on God's rules. Ethics is one of the influential factors in reaching social justice. Nasrabadi (2006) cites Taheri (2005) who concluded that the economy in Islam is considered to be related to ethics and, ethics is related to religion. Consequently, Islam requires Muslims to follow the path of justice, goodwill and honesty and recognize profit in business activities as a secondary outcome (Shaari, Russell & Frank, 1993).

Islamic rule dictates that Muslims are not allowed to harm themselves or others by any action, including business activities. Also, Islam requires Muslims to organize their business relationships in accordance with Islamic principles. Islamic traditions impact on business relationships. For instance; Islam has ethical rules and recommendations about business touching upon the individual's commitment to trust and justice (Shaari, Russel, & Frank, 1993). Furthermore, according to Nasrabadi, (2006), and Motahhari (1991) say that Islam requires Muslims to follow the path of justice, goodwill and honesty. Islam recognizes profit in business activities as only a secondary measure of efficiency. In Islam people, in general, are seen as trustworthy, unless proved to the contrary. In addition, Islam encourages social interaction and group activities (Nasrabadi, 2006).

Attia et al (1999, cited in Marta, Singhapakdi, Attia, and Vitell, 2004) make the point that "the Arabic cultural environment encompassing religion, language, customs, social etiquette and laws constitutes a strong barrier toward conducting research" (i.e. the way it is conducted in the western societies).

In the Middle East & North Africa (MENA), Islam is the main source of written laws and most of the legal environment surrounding business transactions (Marta et al, 2004). In the same way Saeed et al (2001, cited in Marta et al, 2004) state that “Islamic teachings are extremely rooted in the principles of equity and justice in business practices and offer a structure that creates values and raises the standard of living of all parties involved in the exchange, while holding to these principles and guidelines”. This ethical framework has realistic applications in different Muslim countries where sales training guidelines, marketing, and codes of ethics are consistent with Islamic values. It provides a useful and common in the framework of the Middle East and North Africa (MENA), not just “an American approach” (p55).

However, Attia et al (1999) also observe that participants in Middle-Eastern markets are not as likely to perceive ethical content in doing business. According to Shaari et al (1993), social justice in Islam comes from ethical behaviour and it should be evident in the kindness and integrity of corporate managers. Muslims who believe in the rule of Islam are not allowed to harm themselves or others, or should refrain from causing harm to themselves or others. Therefore, the level of trust is increased when people behave in accordance with Islamic rules and ethical principles.

There are differences between capital markets in developing countries and capital markets in developed countries. These differences are related to the nature of emerging markets; they usually suffer from: a lack of shareholder and creditor protection, a lower level of market efficiency, a lack of implementation of the existing rules and legislations, and cultural factors such as religion, which may influence the relationships between financial analysts and corporate managers. For instance, Islam may strongly influence businesses relationships in Iran as a country which is overwhelmingly Muslim (99%) (As Vishny, 1998., Walczak, 1999., & Gomes, 2000, cited in Nasrabadi, 2006).

Islamic investors may be worried about a different set of ethical criteria from Western ‘green’ or ethical investors, but the issues of screening techniques and stock selection are of mutual interest. Arguably both Islamic and Western investors can learn from each other, especially with respect to investment techniques even though the underlying moral value systems are very different, and there is no question of importing or exporting cultural standards or religious beliefs (Wilson, 1997). In addition Wilson (1997) also argues that “Islamic investors have a variety of

choices when constructing a financial portfolio. These choices includes; riba (interest free) bank deposits, investments in Islamic unit trusts and investment companies, private placements in Muslim businesses and investments in conventional institutions and businesses which undertake to deploy funding from Islamic investors on a halal basis. Options regarded by many as haram (forbidden) include conventional bank savings and investment deposits, the purchase of interest yielding bonds, and the acquisition of shares in companies involved in alcohol production or distribution or in pork products” (p. 1331). In that case, what matters is the main business activity of companies- whether these companies involved with riba - based banks (interest) or not. If company accounts could be dissected, and halal separated from haram, a Muslim fund could be concentrated on the former.

In organising such business relationships, there is a contractual basis. The Qur’an distinguishes between two different kind of trust; contractual trust, and relationship trust. Contractual trust takes the form of a contract written between traders to ensure that everyone has his/her rights defined as “*not all people can be trusted*” Fukuyama (1996) says, therefore, this kind of contract is used to keep all parties rights safe. Although, if there is no way to write down the contract for any reason, traders should use instead, two witnesses to at least to prove the rights of each party. This means that people can use any kind of contract which can be proved, and therefore it can keep the rights of all parties safe. The second type of trust is the relationship trust; the Qur’an also encourages people to be honest and trustworthy.

Furthermore, The Prophet Mohammad (Peace Be Upon Him) said, “*who cheats is not anymore one of us*”. Thus Muslim people are required to have a good and trustful relationship. As a result, an Islamic stock market should include both contractual trust and relationship trust to work successfully. The Qur’an encourages effort and improvement; however, the underdevelopment of many Islamic countries cannot be attributed to Islam per se, but as Guiso et al, (2003) point out, the reason for this situation is possibly due to the development, somewhere in between the 9<sup>th</sup> and the 11<sup>th</sup> century, of inflexible legal and political institutions in the Islamic world intended to discourage growth and aimed at preserving the status quo.

As a result, Platteau (2008) points out that the development of a modern economy has not taken place in Muslim lands without organizational change. Lydon (2007) cited in Platteau (2008) states that the essential flaw in Islamic legal systems is their failure to invest paperwork

with legal personality; therefore he has given further support to the Qur'an's thesis. Paradoxically, while the Qur'an verses place 'great emphasis on the importance of writing and documenting credit transactions, written documents such as debt contracts and even Fatwas have no value in and of themselves and cannot therefore be used as legal evidence in a court of law. This lack of faith in paper stem from the belief that documents can easily be tampered with or simply forged, whereas oral testimonies given under an oath by witnesses are more reliable. This limitation constitutes a serious obstacle to the modern development of Muslim economies because it inhibits the growth of 'paper companies', such as joint-stock companies or corporations as well as the development of complex and large-scale enterprise in commerce, industry, and the key sector of banking (Platteau, 2008).

There has been some discussion over the intrinsic worth of having specifically Islamic stock exchanges. Malaysia is predominantly Islamic and it has the biggest stock market in the Islamic world. In spite of the size of the Malaysian stock market, this stock market exhibits considerable volume and price volatility (Nasrabadi, 2006). In an imperfect Arab world in particular MENA countries, where most financial markets do not function according to the Islamic law (Shariah), pragmatism may be considered the most appropriate way of serving Muslim interests (Marta et al, 2004).

### **Libyan Stock Market**

Libya adopted during the period from 1970 to 1990 a socialist-oriented economy, which established full dominance of the public sector and its institutions in all economic activities. Since 1992 Libya has adopted a market-based economy, and implemented a privatisation strategy, which clearly requires new organizational systems (Twati, 2006). However, the Libyan economy operated under economic sanctions from 1992-1998, which affected the privatization process. The Libyan financial market is dominated by conventional banks (interest based banks). In 2006 the Libyan stock market was established. Due to a general lack of knowledge about dealing on the stock markets, the Libyan stock market may face barriers from a culture of fear and distrust. Therefore, the Libyan stock market should work in two levels; building trust inside and outside the stock market to achieve its development. The lack of trust could explain the limited participation on the stock market (Guiso et al, 2007). Also, as trust is fostered through the operation of tribal and clan systems, there is often a clear 'chieftain' to who service is 'owed', but

from whom protection flows. This typical reciprocal bond is based in trust. Market and clan organizations exist because each of them, and, under certain conditions, offers the lowest transactions cost.

The Libyan government allows its companies and banks to deal normally in western financial markets without considering the culture and religious aspects, which means that Libyan people have no other choices to accept or decline dealing with these banks and companies. Libya is a developing country with an emerging economy and the capital market, which has started to transfer some public areas of economic activities to the private sector (privatization). As a result, the number of private investors in the Libyan stock market has increased. This development of the stock exchange is an important factor in business investment decisions. However, most Libyan people are also religious. Therefore this may affect the investment decision in the Libyan Stock Market, which has only listed banks and insurance companies which do not conform to the Shariah law because they contain the haram elements of interest (Riba), uncertainty (Gharar), and gambling (Maisir). For this reason, the Libyan Stock Market may face a difficulty in increasing the number of the investors.

## **Conclusion**

Stock markets operate in climate of trust. The motto of the London stock exchange, “*Dictum meum pectum*” (my word is my bond) exemplifies this. Trust has a major role to play in the development of new stock markets, such as that in Libya.

The literature review clearly suggests that the key concept of trust (however it may be defined - and this is a major aspect of future work) is affected by social and cultural values. The values held by Libyan society stem from two major sources: the first is the intrinsically tribal, clan and family based social structure and second, an overwhelmingly Islamic religious tradition. The basis for trust in the social and the religious sphere are shown to be different, the first emphasising trust of ‘kinship group members’, the second with its Qur’an injunction for a more generalized trust and a morally informed code for interaction with strangers.

A Libyan culture which is based on clans and tribes suggests a low level of trust outside the clan or the tribe; as a result, aggregate Libyan society may have a lower level of trust in the Libyan stock market. A perspective based on Islam would, in general, be more appropriate to

stock market development (at least as far as trust is concerned). The need is to bring a Qur'an perspective and harness it to a regulatory framework that serves to build a general climate of trust in the stock market and its operations. This would serve development needs in Libya well.

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