ADDIS ABABA UNIVERSITY SCHOOL OF COMMERCE POST GRADUATE STUDIES

THE ROLE OF EMERGING CAPITAL MARKET IN CAPITAL ALLOCATION: *THE CASE OF ETHIOPIAN CAPITAL MARKET*

A Thesis submitted to Addis Ababa university School of Commerce in Partial Fulfillment of the requirement for the degree of Master of Science in Corporate Finance: With specialty in Investment Management.

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As members of the board of examiners, we examined this thesis entitled "*The Role of Emerging Capital Market in Capital allocation: The case of Ethiopian capital Market*" by Mr. Denekew Aderaw, We hereby certify that this thesis is accepted or fulfilling the requirement or the award of the degree of Master of "Corporate finance: With specialty in Investment Management''.

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DECLARATION

I, hereby declare that this thesis entitled "*The Role of Emerging Capital Market in Capital allocation: The case of Ethiopian capital Market*" has been carried out by me under the guidance and supervision of Dr. Tenkir Seifu.

The thesis is original and has not been submitted for the award of any degree or diploma to any university and institution.

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This is to certify that the thesis entitles “The Role of Emerging Capital Market in Capital allocation: The case of Ethiopian capital Market”, submitted to Addis Ababa university school of commerce for the award of Master of Corporate finance: With specialty in Investment Management and a record of bona fide research work carried out by Mr. Denekew Aderaw, under our guidance and supervision.

Therefore, we hereby declare that on part of this thesis has been submitted to any other university or institution for the award of any degree or diploma.

Advisor’s Name	Date	Signature
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ACRONYEMS/ABRIVATIONS

DCF.....…...Discounted Cash Flow

ECMA……....Ethiopian Capital Market Authority

EMH…….....Efficient Market Hypothesis

EPS…….Earning Per Share

FR .....…...Financial Report

FDI……...……Foreign Direct Investment

GDP……..…Growth Domestic Product

IOSCO…….....International Organization of Securities Commission

IMF……..International Monetary Fund

ROI …….....Return on Investment

SEC ……..Securities and Exchange Commission

SPSS…….Statistical Package For Social Science

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Abstract

One of the remarkable phenomena of the 21st century is the globalization of both factor and product markets, which has significantly transformed economies worldwide. This globalization has created a myriad of opportunities, particularly for developing countries, by providing them with greater access to a diverse array of products and services from developed nations. For these emerging economies, this access means not only the ability to import advanced technologies and high-quality goods but also the potential to integrate into global supply chains. Such integration can spur local industries, enhance productivity, and ultimately contribute to economic growth. Conversely, developed countries also reap substantial benefits from this interconnectedness. They gain access to a wealth of opportunities for diversification, allowing them to explore new markets and reduce dependency on their domestic economies. Additionally, globalization enables these nations to tap into inexpensive labor pools in developing regions, which can significantly lower production costs. Moreover, the availability of untouched natural resources in various parts of the world presents an avenue for developed countries to secure essential materials that are critical for their industries. Lastly, the presence of high purchasing power in certain global markets allows developed nations to expand their consumer base, driving further economic growth and innovation.

The establishment of deep, liquid, and well- regulated capital markets are instrumental in financing the economy and are the foundation for thriving private sector, a key driver of jobs and growth. The study endeavors to investigate the role of the capital market that helps to ensure the financial systems efficiency, stability, risk management, preventing costly crises, and helping channel savings toward capital that is essential for economic development and poverty reduction.

The paper utilized financial development, trading volume, liquidity, information disclosure as a proxy measure of capital market performance. It also used profitability, shareholders wealth creation, and long- term business sustainability to measure capital allocation efficiency.

Key words: Capital allocation; Capital Market authority; Market efficiency.

CHAPTER ONE

1. INTRODUCTION

1.1 Background of the study

According to the final report of International Organization of Securities Commission FR09/2020, Economic development occurs through the accumulation of capital, both physical and human, and the acquisition and application of advanced technologies. Central to the accumulation of capital is the saving investment process in which savings are channeled into investment or gross capital formation. The financial market plays a pivotal role in this process by facilitating the movement of funds from surplus to deficit units. The process has ensured that savings are allocated to the most productive and profitable capital projects. Investment in new productive capital projects leads to immediate higher levels of economic activity and a higher level of sustainable economic growth. On the contrary the failure to direct those immense financial resources to the most productive investment impose substantial real cost to the economy. To strengthen the idea Bekaert and et al (2005), mentioned that an efficient financial market is one of the factors for economic growth in order to facilitate the provision of domestic saving and foreign Capital for prospectus investment.

The International Organization of Securities Commission held a meeting in February 2020, on the issue that accelerating efforts to develop domestic capital markets is essential to support economic growth and enhance financial resilience and inclusion.

According to Abdullah (2012), Capital market is the segment of the market in which long term financial assets (securities with more than one year of maturity such as government and corporate bonds, stocks, and other financial products) are traded. Thus it is crucial for the process as it provides a platform for businesses to raise capital for expansion and growth, which is essential for enhancing productivity and improving income differentials among countries.

According to Eugene F. (1991), stated that efficient capital markets are commonly thought of as markets in which security prices fully reflect all relevant information that is available about the fundamental value of the securities. Because security derives its worth from its claim on future cash flows. This intrinsic value represents the present worth of the future cash flows expected by the security holder. For stocks, these projected cash flows encompass the anticipated stream of dividends distributed to shareholders, coupled with the expected selling price of the stock itself.

According to Leppenies (2008), states that in neoclassical economic theory, the capital market provides a crucial link between consumers and producers. Because information flows freely between actors' in a free market system. However Informational efficiency is crucial for capital market funds to flow to the most valuable projects. Shareholders aim for management to boost stock prices by choosing projects that enhance stock value. Aligning management's interests with shareholders', compensation linked to stock performance is common. Efficient markets prevent short-term focus over long-term projects. Moreover, they facilitate easier capital raising as market prices determine investors' willingness to exchange claims on future cash flows.

According to S.P. Kothari (2001), shows that Market efficiency holds significant implications for the finance industry, particularly for accounting professionals. In an efficient market, the rewards reaped from fundamental analysis decrease. This reduction stems from the notion that all relevant information is already reflected in security prices, leaving little room for investors to exploit undervalued or overvalued assets.

According to Lauren S. (2022), stated that Capital allocation is the distribution, re-distribution, and investment of financial resources to maximize stakeholder profits. It's a strategic financial decision made by chief executive and chief financial officers that's critical to a company's long-term success. Thus, allocation of this financial resource for the best use indicates an organization is healthy, successful, and worth investing in and often leads to compounded shareholder wealth.

Efficient capital allocation is linked to productivity improvement and growth in real output, highlighting the need to explore the impact of capital optimization on the economy. Eugene F. Fama (2020) argued that the capital market plays a crucial role in allocating ownership of the economy's capital stock, facilitating firms' production-investment decisions and allowing investors to choose among securities that represent ownership of firms' activities under the assumption that the security price at any time ''fully reflect'' all available information. This information processing capability is critical to continually reallocating resources to their best use in such an over changing environment Hayek's (1975). The essence of this system is that, when individuals have economic freedom and secure private property rights, profit incentives lead them to collect information through the market and allocate resources efficiently.

According to Will Kenton (2020), stated that capital allocation function is a cornerstone principle in finance, guiding companies and investors determine how to deploy its financial resources across different area of a business. It refers to the strategic process of allocating financial resources – capital – by evaluating investment opportunities. To strengthen the notion Jorgenson and Yun (1986) highlighted that capital allocation function seeks to achieve an optimal balance between different investment options. Companies must carefully consider factors like: Profitability: Investing in projects with the highest potential return on investment (ROI). Risk: Balancing the potential for high returns with the risk of losses. Growth: Directing resources towards opportunities that drive long-term business expansion. Liquidity: Maintaining sufficient cash flow to meet operational needs and short-term obligations.

According to Prateek Agarwal (2022), resource allocation in the real world can prove quite challenging as markets are generally imperfect with high transaction costs and asymmetrical informational sharing. However, most countries strive to operate at a point where they utilize their resources in the most efficient manner possible. The essence of resource allocation function in a market economy is that more resources should be flowing to activities with a high payoff prospect. Firms, established and startup, with a better payoff prospect obtain financing and consequently expand their physical investment, compete more successfully to procure raw materials and labor, and ultimately expand production. Wurgler (2000) mentions that a direct measure of the quality of capital allocation, His starting point is that the higher quality capital allocation implies more investment in industries that are growing rapidly and less investment in declining industries. He also finds poor quality capital allocation to be associated with state ownership and poor minority investor rights. These flows of resources in the capital market verify positive contributions of economic growth Levine (2000 and 1997).

According to the IOSCO report FR09/2020, following the global crisis of 2006 the capital market generally and market based finance could play a massive role in providing a viable alternative to the banking sector. Proponents of capital market development in developing economies argue for its contribution in liquidity, private sector development, risk diversification, acquisition of information about firms, corporate governance, efficient capital allocation, saving mobilization and reducing dependency on banking sector by complementing it, not substituting.

According to Murinde (2006), noted that capital market development is important in developing countries to complement and facilitate reforms in the banking sector. It is also noted by Ouandlous (2010), for emerging economies to imitate the achievement of the advanced economies, they have to establish and develop capital markets. Thus philosophical changes and shifts in recent years have happened in many African countries by refreshing their economy and political system by Asrat (2003). Our country, Ethiopia, is the one that makes different reforms in recent years and financial sector reform has become part of its development agenda. A study made by Murinde (1999), also highlights the importance of the capital market in attracting foreign portfolio investment, private sector development and the integration of the domestic economy to the worldwide.

Ethiopia is not exceptional for this; the primary advantage of this market in improving allocative efficiency is that it provides a venue through which local businesses and the Government sector can acquire capital through the sale of shares and issuing bonds. Currently, the process of acquiring a sizable amount of capital or investment in private and public enterprise is through acquiring a bank loan or various other forms of credit. Usually, the interest rates on these loans are relatively high, and in more recent times during the credit crunch, it has been very difficult to find credit at any price. High- interest credit is an opportunity cost to expenditure on a product, and in some cases, projects have to be abandoned due to the difficulty of acquiring credit at any price. Therefore the existence of a capital market can encourage investment and capital expenditure. This will shift resources into more profitable projects and increase the long run economic growth rate.

This study is unique in its focus on a market that is still in its early stages of development, offering insights into the challenges and opportunities faced by emerging capital markets. Addressing these gaps can provide valuable insights into enhancing the efficiency of the Ethiopian capital market and improving capital allocation practices in the country. This research aims to investigate the prospective state of the Ethiopian capital market and its effectiveness in allocating capital efficiently. It will also explore lessons from international capital markets to suggest improvements and strategies for enhancing the role of the Ethiopian capital market in efficient capital allocation.

1.2 Statement of the problem

The capital markets facilitates the mobilization and allocation of medium and long term funds for productive investment by; Providing a simple mechanism for the transfer of funds, facilitating companies access to a large number of local and foreign investors. Widening the array of financial instrument available to savers and investors; increasing diversity and competition in the financial systems and lastly providing market signals on current situations and future expectations Wambui Kibuthu (2005). This helps to alleviate stresses on the banking system by aligning long-term investments with long-term capital.

Capital market play an important role in the economic growth through facilitating capital mobilization as well as domestic savings. According to Daillami and Atkin (1990), the provision of funds to finance domestic capital formation as a key factor in the prospect for the long term economic growth in developing countries. It pay increased attention to capital market development as a way of improving domestic resource mobilization, redistribution, and channeling them to most growth prospect.

Most of the Ethiopian businesses have difficulties in raising their long-term capital. The business sector has depended mainly on short term financing to finance even long term projects, such as use of overdrafts. Based on the maturity-matching concept such Financing is risky and inefficient. This firms need to raise an appropriate mix of short- term and long term capital.

The current literature on the Ethiopian capital market primarily focuses on its development, challenges, and potential for growth; there is a lack of in-depth research on the specific role of the Ethiopian capital market in facilitating capital allocation. Existing studies often provide a broad overview of the market without delving into the mechanisms through which capital is allocated and the factors that influence this process.

This research aims to fill these gaps by examining the current state of the emerging capital market and how it's to be effective in allocating capitals. Ultimately, Understanding the role of the emerging capital market in capital allocation function is essential for policymakers, regulators, and market participants to address these challenges and promote economic development.

1.3. Research question

1. How does the level of financial development influence the capital allocation function?

2. To what extent does information disclosure practice influence capital allocation function?
3. To what extent does the level of market liquidity affect capital allocation function?
4. To what extent that Market volatility influence capital allocation function?

1.4 Objective of the study

1.4.1 General objective

The primary objective of this paper is to highlight the significant role of the Ethiopian capital market in facilitating capital allocation function within the economy.

1.4.2 Specific objective

1. To analyze the impact of information disclosure practice on capital allocation function.
2. To examine the effect of market liquidity on capital allocation function.
3. To analyze the impact of financial development indicators through quantitative analysis of market depth, market access, and market efficiency on capital allocation function.
4. To examine the effect of market volatility on capital allocation function.

J. Wurgler (2000) has proposed a model for evaluating financial market and the allocation of capital. The following hypothesis was developed based on this model, on capital market and capital allocation. Accordingly. I hypothesized that each of those variables has a significantly effect on capital allocation.

1.6 Hypothesis

H1: Financial development has positive and significant effect on capital allocation function.

H2: Information disclosure has positive and significant effect on capital allocation function.

H3: Market liquidity has positive and significant effect on capital allocation function.

H4: Market volatility has positive and significant effect on capital allocation function.

1.7 Significance of the study

Ethiopia's nascent capital market holds immense potential for revolutionizing how finance flows within the country. Thus, it also became a game changer, driving efficient capital allocation, fostering financial inclusion, overcoming challenges and nurturing its development will be crucial for unlocking its full potential for the nation. Ethiopian capital market will be expected to offer alternative financing options for a business and government potentially lowering cost of capital

and increasing competition that will be hopeful to ceasefire the current financial constraints happening in the banking sector. So establishing an efficient Ethiopian capital market will unlock significant economic potential by directing resources to where they are needed most, ultimately contributing to sustainable development and prosperity.

The overall intent of this paper will be to show a brief explanation about the vital role of the emerging capital market in our nation in resource allocation function by offering attractive investment options for investors and encouraging saving and long-term financial planning.

1.8 Scope and limitation of the study

This study emphasized on the role of the emerging Ethiopian capital market in efficient capital allocation. Thus, the study would not cover aspects related to the provision of capital. The study would also exclude discussions on the governance role played by emerging capital markets.

The Ethiopian capital market is relatively new. With regard to this, it made pitiful for getting the available data and historical context that was constrain the depth and accuracy of the analysis.

Ethiopian capital market authority is an autonomous federal government regulatory authority with its own juridical entity, and directly accountable to the prime minister. Thus, this study was not fully explore the impact of government policies and regulations on the market's efficiency.

1.9. Organization of the study

The study is organized into four chapters. The first chapter deals with the introduction where the statement of the problem, research question, objective of the study, hypothesis, significance, scope/delimitation, and organization of the paper are included. The second chapter is devoted to literature review on the concept and functioning of the capital market. In section three, detail of philosophy followed to accomplish results would be illustrated. The study's design, sampling, sampling method, data source and type, and data analysis are all included. Chapter four is devoted to interpretation and analysis of Ethiopian capital market role from the experiences of other countries along with the discussion of their implication on Ethiopia, and finally chapter five presents summary, conclusions and recommendation.

CHAPTER TWO

2. LITERATURE REVIEW

2.1 Introduction

Jennex (2015) defines a literature review as a systematic process involving the collection, comparison, analysis, synthesis, and evaluation of published research to establish a robust foundation for a given topic. Expanding on this idea, Serrador (2013) emphasizes that the purpose of a literature review is to summarize existing research by identifying patterns, themes, and issues. This process not only clarifies the conceptual landscape of the field but also contributes to the development of theoretical frameworks. This section presents about capital market theory and approach of capital allocation efficiently and the determinant factors of market efficiency. Further, this section compiled the findings from different reviewed literature on capital market efficiency and their role on allocation function.

2.2 Theoretical review

Financial market

According Assefa (2002), states that financial market is referred organizational framework within which financial instruments and claims (Treasury bill, government and corporate bond, equities and the like) can be traded. In this market, lenders have the option to engage in buying and selling existing liabilities from one another. Example of well- functioned marker are the stock exchange in major financial centers such as London, New work and Tokyo. According to Jeff Mudura (2008) financial market classified as money market and capital market, based on maturity.

Money market

According Jeff Mudura (2008), states that Money market securities are debt securities that have a maturity of one year or less. Those are generally characterized by a relatively high degree of liquidity. On his explanation money market securities tend have a low expected return and but also have a low exposure of risk. Common types of money market securities includes treasury bills (issued by the government), commercial paper (issued by corporations), and negotiable certificate of deposit (issued by depository institutions).

Capital market

According to abdullah (2018), capital market is the segment of the market in which long term financial assets (securities with more than one year to maturity such as government and corporate bond, stock equities) are channeled. According to his explanation capital market is divided in to two namely, primary market and secondary market. Primary market is the part of the market through which new issue of new securities is carried out, which referred to as the new issues market. Moreover, in the primary market listed companies raise their und when they need by issuing and selling long term securities such as stocks and bonds to potential investors. He also state that secondary market is a market that already- issued securities is takes place among investors. The occurrence of this transaction is not any addition of the outstanding securities beyond ownership possession.

What is an efficient market?

According to Fama (1970), stated that an efficient Market is the one where the market price is an unbiased estimate of the true value of the investment. In other words, an efficient capital market is one where traders cannot gain an advantage by using public information to speculate on the stocks available.

An efficient market is one where the price of an asset accurately reflects all available information. This arises from the competitive efforts of securities analysts and investors. They seek to identify mispriced securities, which are either undervalued or overvalued. Securities analysts aim to uncover information that indicates disparities between the current market price and the intrinsic value of securities. Upon discovering such information, securities analysts take action by buying, selling, or recommending securities. This process ensures that if securities prices do not adjust quickly and impartially, investors could profit by trading during periods when securities fail to reflect all relevant information or when the market either overcompensates or under compensates for new information. Similarly, if securities prices do not move randomly, investors could exploit systematic price movements to earn returns above the average.

Fama, E. F. also stated that Insider trading, which involves trading by individuals with access to nonpublic information, also contributes to the efficiency of the capital market.

In an efficient market, where a large number of buyers and sellers react through a market mechanism such as the New York Stock Exchange, market prices should fully and instantly reflect all available information about a company's securities. In such a market, investors should not be able to systematically "beat the market" by identifying undervalued or overvalued securities.

If the market operates efficiently, confidence will be generated in the minds of the public and thus, investors will be willing to part with hard earned funds and invest them in securities with the hope that in the future they recoup their investment. On the other hand, if the market is unreasonable, predictive and speculative, investors will be discouraged to invest their funds.

In economics where, general property rights are better honored, and private property rights more securely protected, two things happen. First, asset prices are true indicators of true investment value because of the profit the large number of arbitrageurs make as their trading pushes asset values towards true values. Second, managers are more trustworthy agents for investors because more efficient asset prices render corporations more transparent to investors, and thereby expose insider theft and incompetence La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1999).

2.1.1 Theory of efficient market hypothesis

The Efficient Market Hypothesis (EMH) is a cornerstone theory in finance that posits that asset prices reflect all available information. The concept was introduced over half a century ago, initially focusing on rapid market adjustment to new information. However, a more modern definition emphasizes that asset prices fully reflect all available information, implying rational information processing without ignoring relevant information or making systematic errors Fama (1991).

The EMH argues that efficient markets lead to price discovery, reflecting all relevant information. A precondition for this strong version of the hypothesis is that information cost, the cost of getting asset prices to fully reflect information, is always zero Grossman and Stinglitz (1980). This means that the cost of obtaining information needed to fully reflect asset prices must be negligible. Additionally, the statement mentions a weaker and more practical version of the efficiency hypothesis, which suggests that prices reflect information up to the point where the benefits of acting on the information (potential profits) do not exceed the costs of obtaining and acting on that

information (Jensen, 1978). This weaker version acknowledges that markets may not be perfectly efficient but still operate in a way that prevents easy arbitrage opportunities.

Assefa Worede (2002) state that market in general efficient when (1) price adjust to new information: (2) there is a continuous market in which each successive trade is made at a price close to the previous price (the faster that the price responds to new information and the smaller the difference in price changes, the more efficient the market): and (3) the market can absorb large currency amount without destabilization the price. An efficient capital market quickly and accurately reallocates liquid capital from underperforming investments to those with better prospects. This reallocation occurs only if (1) the promising firm can fairly assess its product's market value to raise funds, and (2) market makers act fairly.

Businesses require two types of market efficiencies: external and internal. External efficiency means that new information is readily available to investors, allowing it to be quickly reflected in security prices. As a result, security prices should accurately represent available information. An efficient capital market is beneficial because it provides capital when needed and rewards investors with capital gains. Internal efficiency is relevant when trading costs and speeds are reasonable, enabling effective resource allocation. Good information is essential for choosing investment options based on expected returns and risks, monitoring firm behavior post-funding, and taking corrective actions if necessary.

Fama (1970b), says that the only test is whether the information is properly reflected in price in the context of a pricing model that defines the meaning of ‘’properly’’. Kun Tracy Wanq, state that ‘although most of countries have enacted laws and rules deterring insiders from trading with private information (Bhattacharya and Daouk, 2002), prior studies report that insiders can circumvent such regulations by trading strategically Noe (1999); Ke et al. (2010); Finnerty (1976); Lelad (1992); Fried (2000); Japolinzer (2009); Louis et al. (2010); Narayan et al. (2014); Westerlund and Narayan (2015). In contrast proponents of insider trading argue that, in a scenario characterized by expensive monitoring and incomplete information, insider trading serves as a means of conveying information to outsiders. This facilitates the swift revelation and pricing of new private information, thereby enhancing market efficiency Carlton and Fischel (1983); Holden and Subrahmanyam (1992); Aktas et al. (2008); Chau and Vayanos 2008; Hsu and Lee (2014). ‘

The potential contribution of insiders' trades to price discovery and market efficiency depend on the ability of other traders to identify insider trading Carlton and Fischel (1983), and that insiders' trading profits are achieved at the expense of outside investors Leland (1992). However, insiders' profit is affected by the accuracy of insiders' private information, and the number of days that insiders have obtained the information in advance. This implies that the importance of information transparency and the ability of other investors in limited insiders' trading advantages to mitigate their exploitation.

2.1.2 Characteristics of Emerging Capital Market

According to, Ellefsen (2004) noted that emerging capital markets show the following characteristics which distinguish them from developed Capital market. First, market size in emerging markets is far smaller than developed markets. The overall size of their economies and the size of their financial market in relation to their economies as a whole is relatively small compared to developed countries. Secondly the market is not open to all. Foreign investors are restricted. There is an ownership restriction. Thirdly, there is market inefficiency in emerging market. New information is not quickly reflected in the securities prices. Fourthly, the policy enrolments in many emerging markets are very unstable. Fifthly, market liquidity in emerging markets is illiquid. Investors in merging market are particularly concern about the case of capital movement owing to emerging markets spotty liquidity.

2.1.2 Market Information and efficiency

Information disclosure is any deliberate release of relevant information, weather numerically or quantitative, required or voluntary via a formal and informal channels Gibbins, Richardson, and Waterhouse (1990). It is an essential component of regulation in the financial market. As Goldstein,I., & Yang, L. (2017) stated that disclosure of information in financial markets is at the forefront of regulatory efforts to improve financial markets quality and stability.

The importance of a strong regulatory environment in promoting efficient capital allocation has been emphasized in various studies. La Porta et al. (2002) conducted a seminal study that found a positive correlation between the quality of investor protection laws and the efficiency of capital markets. This implies that countries with better regulatory environments tend to have more efficient capital markets and better foreign direct investment opportunities. To strengthen the idea, Alfaro et al. (2004) found that countries with efficient capital markets have higher chances of

Foreign Direct Investment (FDI). Thus, it brings new capital, technology, and management practices, which can lead to improvements in productivity and competitiveness.

According to Goldstein,I., & Yang, L. (2017) mention that information disclosure is assessed by the quality and extent of information disclosed by listed companies, including financial statements and corporate governance practices. It is measured by Disclosure Scores: Independent agencies or research firms may assign scores based on the comprehensiveness, timeliness, and accuracy of information disclosed by companies. And Frequency of Filings: The number and timeliness of financial reports and other disclosures submitted to regulatory bodies.

The Ethiopian Capital Market Authority (ECMA) has the centerpiece of this effort is the mandated disclosure of financial information. Ethiopian Capital Market Proclamation No. 1248/2021, enacted in August 2021, is a significant regulatory framework aimed at developing and regulating the Ethiopian capital market. The proclamation replaces the previous Capital Market Proclamation No. 550/2007 and introduces several key changes and provisions to enhance the efficiency, transparency, and investor protection of the Ethiopian capital market. One of the notable changes introduced by Proclamation No. 1248/2021 is the establishment of the Ethiopian Capital Market Authority (ECMA) as the regulatory body responsible for overseeing the capital market. The CMA is tasked with regulating securities issuance, trading, and market intermediaries to ensure compliance with the law and protect investors' interests.

The proclamation also introduces new requirements for market participants, including issuers, brokers, and investment advisors. Issuers are required to disclose accurate and timely information to the public, while brokers and investment advisors must adhere to strict ethical and professional standards. These provisions aim to improve market transparency and investor confidence. Furthermore, Proclamation No. 1248/2021 introduces measures to enhance market integrity and prevent market abuse. It prohibits insider trading, market manipulation, and other fraudulent practices, with penalties for violators. These provisions are essential for maintaining a fair and orderly market environment. Disclosure regulation comes in different forms and affects different activities. Through time, firms have increasingly been required to disclose information about their operation and financial activities in financial reports to the external stakeholders. And also investors are required to disclose information about their holding in firms that might pertain to activism, intentions of activism, or acquisition intention that could ultimately affect the firm value.

Moreover, improved quality of public information is also achieved by increasing the reliability of credit ratings and by greater disclosure of macroeconomic and industry-related information. Following the financial crisis of 2008, governments increased the amount of disclosure available about the banks by conducting annual stress testing and making their results available in public. Disclosure of stress test results informs outsiders whether banks are sufficiently capitalized to observe negative shocks, thereby enhancing market discipline. Such market discipline, in turn, would have prevented insiders from engaging in excessive ex ante risk taking behavior that may have contributed to the existence of financial crises Goldstein and Sapra (2013).

According to Emanuela (1999), argued that informed traders observe the realization of a payoff relevant signal before making portfolio decisions. Uninformed traders have no direct access to this kind of information, but can particularly infer it from market prices. This idea goes back to Hayek (1945), who argued that prices are an important source of information because they aggregate information from many market participants.

In the context of capital markets, signaling theory examines how high-quality ventures can distinguish themselves from low quality firms by sending signals about ventures' true quality. However, in order for the signals to be effective, they must be observable by potential investors and costly to imitate Brain L. Connnelly et al. (2011).

According to Michael Bradley, Gregg A Jarrell, E Han Kim (1984), a new event is defined as information that can change the economic state; that is when a new event occurs, the economic state changes from to, where represents the effect of the new event, refers to a positive news event, and refers to a bad news event. We assume that there are two types of events: first a news event scheduled to occur on a specified date (e.g., an earnings announcement of a company to be released to the stock market on a pre- scheduled date). Second, a news event that occurs during a period (e.g., significant corporate events such as mergers, acquisitions, and changes in corporate control that need to pass various handles before completion, including negotiations with deal parties, and gaining the approval of shareholders and regulators, which are not fully under the control of insiders or a particular party).

These suggest that in the capital market that investors are not entirely irrational, and that cannot fully rely on the competitive force of an economy. Therefore, Regulatory frameworks of Ethiopian capital market authority play a crucial role in mitigating information asymmetry in the markets. The Securities and Exchange Commission (SEC) in the United States, for example, requires publicly traded companies to disclose material information to investors in a timely manner through regulatory filings. This disclosure regime aims to reduce information asymmetry and enhance market transparency.

2.1.3 The Role of market liquidity in capital allocation

Market liquidity is a crucial element of financial markets, significantly impacting the efficiency of capital allocation. It refers to the ease with which an asset can be bought or sold without causing substantial fluctuations in its price. According to Assefa Worede (2002), liquidity encompasses three dimensions:

1. Time - The speed at which an asset can be exchanged for cash.
2. Risk - The potential for the asset's value to depreciate or for the issuer to default on their obligations.
3. Cost - The financial and other sacrifices involved in executing the exchange.

Measuring liquidity across countries can be challenging due to limited data availability. Common indicators include the ratio of total value traded to GDP and the turnover ratio. The total value traded ratio reflects organized equity trading as a proportion of national output, serving as a positive indicator of overall liquidity. Conversely, the turnover ratio indicates transaction costs; a high turnover suggests lower transaction costs, while a low turnover implies higher costs. A liquid market is characterized by a high volume of trading activity, low bid-ask spreads, and a large number of buyers and sellers. Studies have consistently shown a positive correlation between market liquidity and efficient capital allocation. According to Biais et al. (2002), conducted a study that found that more liquid markets tend to allocate capital more efficiently. They argued that liquid markets reduce transaction costs, making it easier for investors to buy and sell assets. This increased ease of trading leads to better price discovery, as market prices more accurately reflect the true value of assets. According Amihud and Mendelson (2008) working paper on "Liquidity, Asset Prices & Financial

Policy" explores the relationship between liquidity, asset prices, and financial policy. While their study does not specifically focus on the Ethiopian capital market, their findings can provide insights into the potential implications for market development in Ethiopia. In the context of the Ethiopian capital market, which is still in its early stages of development, improving liquidity could enhance market efficiency and attract more investors. This could be achieved through measures such as enhancing market infrastructure, promoting investor education, and strengthening regulatory frameworks. By improving liquidity, the Ethiopian capital market could become more attractive to both domestic and foreign investors, leading to increased capital flows and market activity.

2.1.4 Market development in emerging market

Market development refers to the expansion of a financial market in terms of its size, depth, and complexity, resulting in increased liquidity, efficiency, and access to capital. Research indicates that developed capital markets are more effective at allocating capital. For example, Beck et al. (2000) observed that countries with more advanced financial systems tend to allocate capital more effectively, leading to higher economic growth. This is because developed financial markets offer a wider range of allocated capital to the most productive uses.

In his 2007 study, Beck explored the intricate relationship between financial markets and the array of financial products and services available to investors. He noted that these financial tools allow investors to diversify their portfolios, thereby potentially enhancing their financial growth and stability. Beck's research also delved into the broader implications of financial market development, particularly its impact on economic development, income inequality, and poverty levels.

One of Beck's key findings was that as financial markets become more developed, there is a noticeable decrease in income inequality and poverty rates. This suggests that a well-functioning financial system, characterized by diverse financial products and services, can play a significant role in reducing economic disparities. The mechanism behind this phenomenon lies in the enhanced access to finance that accompanies financial market development. Improved access to finance provides individuals and businesses with the opportunity to invest in productive ventures, expand their operations, and ultimately enhance their financial well-being. This access to capital

enables economic actors at all levels to participate more fully in economic activities, leading to a more inclusive and equitable distribution of wealth and income.

The focus of this study is to examine how the Ethiopian capital market is developing, highlighting strategies and policies that have been successful in other developed countries. This research aims to identify and analyze the factors contributing to the growth and effectiveness of the Ethiopian capital market, with the goal of promoting further development and enhancing its role in the economy.

2.1.5 The benefits and challenges of market volatility

According to Shiller's (1981), study on market efficiency and volatility highlights the impact of excessive volatility on the accuracy of asset prices in reflecting underlying fundamentals. Market efficiency refers to the degree to which asset prices incorporate all available information, including information about the fundamental value of the assets. The "fundamental value of the assets" refers to the intrinsic or true value of an asset based on its underlying economic characteristics, cash flows, and future prospects. It represents what an asset is worth based on its fundamentals, such as earnings, dividends, growth potential, and risk.

For stocks, the fundamental value may be estimated using various valuation models, such as discounted cash flow (DCF) analysis, price-to-earnings (P/E) ratios, price-to-book (P/B) ratios, and other financial metrics. These models attempt to quantify the present value of future cash flows or earnings generated by the asset.

In the context of market efficiency Fama, E. F. (1970), suggests that asset prices should reflect not only current market sentiment and trends but also the underlying fundamental value of the assets. In an efficient market, prices would quickly adjust to incorporate any new information that affects the fundamental value of the assets. For example, if a company reports higher-than-expected earnings, positive news about a new product launch, or a favorable regulatory change, this information should lead to an increase in the fundamental value of the company's stock. In an efficient market, the stock price would adjust upward to reflect this new information, ensuring that the stock remains fairly valued relative to its fundamentals. Conversely, if negative news emerges, such as a profit warning, product recall, or regulatory investigation, the fundamental value of the stock may decrease, leading to a corresponding decrease in the stock price in an efficient market.

However, excessive volatility can hinder market efficiency by making it difficult for prices to reflect true asset values, leading to suboptimal capital allocation and market distortions. Shiller's emphasis on measures to reduce volatility, such as improved market regulation, enhanced transparency, and investor education, can help promote market efficiency and stability.

According to French, Schwert, and Stambaugh (1987), shows that news and information play a significant role in driving market volatility. Events such as earnings announcements, economic reports, and geopolitical developments can lead to sharp changes in volatility as investors reassess their expectations. This study conducted a seminal study on the relationship between stock returns and volatility, using data from the U.S. stock market. The study found evidence of a positive relationship between stock returns and volatility, known as the leverage effect. According to the leverage effect, stock prices tend to fall more in response to bad news (increased volatility) than they rise in response to good news (decreased volatility). This asymmetry in the response of stock prices to volatility has important implications for risk management and asset pricing. The findings of French, Schwert, and Stambaugh (1987) have been influential in the development of models for understanding and forecasting volatility in financial markets.

According to Bollerslev and Melvin (1994), conducted a study that examined the relationship between market volatility and bid-ask spreads in the foreign exchange market. They found that periods of high volatility were associated with wider bid-ask spreads, as market makers and traders sought to protect themselves from increased price fluctuations. This increased spread can act as a deterrent for traders, leading to lower trading volumes. For investors, wider spreads mean higher transaction costs, as they must pay a higher price when buying and receive a lower price when selling. This can reduce the profitability of trading and discourage active participation in the market. For market makers and liquidity providers, wider spreads can increase the risk of adverse selection, where they are more likely to trade with informed traders who have superior information. This can further reduce liquidity in the market and lead to a vicious cycle of wider spreads and lower trading volumes.

2.1.6 Market microstructure theory

The field of market microstructure encompasses a wide range of interests, including: (1) price formation, which involves understanding the dynamic process through which prices reflect available information, (2) market structure and design, which examines the relationship between price formation and trading protocols,

(3) transparency, which pertains to the ability of market participants to access information about the trading process, and (4) its application to other areas of finance such as asset pricing, international finance, and corporate finance Ananth Maduanhav (2000).

1. Price formation: Market microstructure studies how prices are determined in financial markets. It considers factors such as order flow, trading volume, and bid-ask spreads, and market depth. The dynamic process by which prices incorporate new information is of particular interest, as it helps understand how efficiently prices reflect all available information

2. Market structure and design: Market microstructure examines the design of financial markets, including the rules and protocols that govern trading. This includes the role of different trading venues (e.g., exchanges, alternative trading systems), trading mechanisms (e.g., continuous trading, auctions), and market makers in shaping market dynamics.

3. Transparency: Transparency refers to the degree to which market participants can observe information about the trading process. Market microstructure examines how transparency affects market efficiency, liquidity, and price discovery. It also considers the impact of regulatory initiatives aimed at increasing transparency, such as the disclosure of trade data and order book information.

4. Application to other finance: Market microstructure has broader implications for various areas of finance. In asset pricing, microstructure research has shown how market frictions and trading costs can affect the pricing of financial assets. In international finance, it examines how market microstructure varies across different countries and how this affects cross-border investments. In corporate finance, it explores how firms can use market microstructure insights to optimize their financing and investment decisions.

Many of the informational issues about market microstructure concern transparency and disclosure. Disclosing information should allow investors to better estimate the extent of noisy trading, thus increasing the markets vulnerability to asymmetric information effects. According to Ananth, market architecture designates the set of rules governing the trading process. Many academic studies have shown the market structure matters by affecting the speed and quality of price discovery, liquidity, and the cost of trading. Market architecture is determined by choices

regarding a variety of attributes such as, degree of continuity, dealer presence, automation, protocol, pre and post trade transparency, and information dissemination.

It is relevant for understanding how capital markets facilitate the efficient allocation of capital through trading mechanisms and market dynamics.

If the participants in the capital market behave rationally and have the same information, share price at all times fully reflects all available information about a company's fundamentals. This has been one of the most important hypotheses in financial economics.

However, microstructure theory challenges the hypotheses of efficient markets by studying how prices can deviate from (or converge towards) informationally efficient equilibrium prices as a result of rational participants behaving strategically Biais et al. (2004). Strategic behavior can be put down to unequal access to information or to limited liquidity in the secondary market.

Biais et al. (2004)," examine the issue of price formation in financial markets, specifically focusing on how market microstructure affects price efficiency and the allocation of capital. The paper addresses various aspects of market microstructure, including the impact of trading mechanisms, market liquidity, information asymmetry, and the behavior of market participants on price formation. One of the key issues highlighted in the paper is the role of market frictions, such as transaction costs and information asymmetry, in influencing price dynamics. The authors argue that these frictions can lead to deviations from the efficient market hypothesis, where prices fully reflect all available information. Instead, market frictions can result in price distortions and inefficiencies, affecting the allocation of capital and the overall functioning of financial markets. Biais et al. also discuss the implications of their findings for market regulation and the design of trading mechanisms. They suggest that improving market transparency, reducing trading costs, and enhancing market liquidity can help mitigate the impact of market frictions and improve price formation efficiency.

While the efficient market hypothesis abstract from the actual process which leads to buyers and sellers finding one another and agreeing on a price. The microstructure literature focuses on the function performed by the marketplace. O Hara (2003) argues that it is important to study the significance of market microstructure for long term portfolio selection. The market serves as two important functions: one is to provide liquidity for buyers and sellers; second, it's to ensure that

new information is reflected in the prices of securities. These must impact investors' long-term decisions.

2.1.7 Capital allocation efficiency in emerging economies

Capital mismatches are prevalent during the economic growth process of various countries, specifically on capital redundancy and resource mismatches in developing economies Aoki (2005). Thus it hindered the quality and transformation of economic growth. In the process of the economic growth, like Ethiopia usually experience structural changes and technological bias, that shows the time-varying factor of income shares. The decisive factor for achieving rapid economic development lies in catalyzing the allocation of capital. Effective capital allocation can also further drive rapid economic growth and sustainable industrial development far beyond mere accumulation of capital on a large scale. According to the Ten- year development plan of Ethiopia (2021-2030) outlines that one of the strategic pillar is emphasizing on sustainable financing. Thus it achieved through the establishment of effective capital market. The goal of Ethiopian economy development gradually evolved to focus on adjusting the economic structure and optimizing resource allocation, making capital allocation efficiency is a key factor. Before resource allocation is optimized it needs effective measurement of capital allocation efficiency.

In accordance with neoclassical general equilibrium theory, the complete effectiveness of resource allocation occurs only when the price of a factor equals its marginal productivity.

2.2 Empirical review

In the body of literature there is also empirical evidence that suggests alternative approaches to measure the efficiency of the capital market in allocation function. Daniel Shaviro (2012), conducting his work about financing firms with a market value below the intrinsic or replacement value becomes an efficient strategy. Intrinsic value is crucial for investors to figure out undervalued stocks, indicating profitable investment opportunities. For stock, the intrinsic value may be estimated using various valuation models, such as discounted cash flow (DCF) analysis, price-to-earnings (P/E) ratios, price-to-book (P/B) ratios, and other financial metrics. These models attempt to quantify the present value of future cash flows or earnings generated by the asset. By investing in those undervalued firms, investors can potentially capitalize on the expectation that profits will rise in the future. This implies that firms can enhance their competitiveness and profitability by

strategically investing in assets when they are undervalued relative to their intrinsic or replacement value.

According to Wurgler (2000), building upon the insights of Hubbard (1998), suggesting the utilization of the elasticity of investment growth as a proxy for financing growth to value-added growth, serving as a proxy for investment opportunity expansion. When investment growth is elastic, meaning it responds strongly to changes in financing conditions, it suggests that firms are actively expanding their investment activities to capitalize on new opportunities. It allows analysts to indirectly assess how firms are utilizing financing to enhance their value-added activities, such as innovation, expansion into new markets, or improving operational efficiency. Therefore, by analyzing the elasticity of investment growth, analysts can gain insights into the dynamics of investment opportunity expansion within firms. Specifically, According to Wurgler demonstration, across a diverse array of countries and industries, a positive correlation between value-added growth and Tobin's Q (the ratio between the market value and the intrinsic value of the asset to the company). Consequently, a higher elasticity of investment growth to value-added emerges as a reliable indicator of enhanced allocative efficiency, indicative of the swift reallocation of funds toward sectors offering greater opportunities. This analytical approach has seen widespread adoption within the finance literature, notably in studies by Beck et al. (2007), Hartmann et al. (2007), Morck et al. (2011), and Lee et al. (2016).

One key finding is the positive association between well-developed capital markets and higher economic growth Rajan and Zingales (1998). To strengthen the idea, Demirgüç-Kunt and Maksimovic (1998) examine that this relationship is attributed to the role of capital markets in providing firms with access to financing, enabling them to undertake new projects and expand their operations.

According to Alfaro et al. (2004) found that countries with efficient capital markets have higher chances of Foreign Direct Investment (FDI). Thus, it brings new capital, technology, and management practices, which can lead to improvements in productivity and competitiveness.

However the causal link between financial factors and economic development is crucially dependent upon the nature and operation of financial institutions, markets and policies pursued by individual countries. Murinde (2020) stated that, the relationship between stock market and

economic development in the USA was largely positive, but there was an insignificant relationship in the case of Germany. This concludes that the role of the capital market can be dire between countries.

In the case of Ethiopia, the lack of a developed capital market has been identified as a significant obstacle to economic growth World Bank (2020). Strengthening the notion Tiruneh (2012) verified the relevance of establishing a financial market in Ethiopia is the power to further speed up the growth of the economy. In his empirical study he figured out the importance of the financial market that encourages the involvement of the private sector in the economy. He also highlighted the role of the financial market in mobilization of local savings, enhanced competition among financial institutions, enhancement of world remittance, strengthened corporate governance, rewarded sound economic policy, improved the source of project financing, and ultimately helped privatization efforts.

The academic literature information disclosure is also quite ambiguous about the effect of disclosure and the overall desirability. It is well understood that disclosure can potentially promote some important goals: by leveling the playing field in financial markets, it can increase market liquidity and market efficiency and can decrease the cost of capital of the firms. However, much has been written about potential unintended consequences of disclosure, which occur because of the crowding out of private information production, the destruction of risk- sharing opportunities, and the promotion of destabilization beauty contest incentives, leading all investors to want to do the same thing.

According to Morries & shin (2002), shows that greater precision of public information leads investors to put much weight on it, thus reducing welfare Given the flow of new regulations related to disclosure in recent years, researchers have been delving more and more into the topic, trying to understand the pros and cons of and answering key questions, such as, what is the optimal level of disclosure in terms of promoting market quality and social welfare? What types of disclosure are most beneficial? In what circumstances is disclosure desirable? This enables the analysis of optimal disclosure in light of its effect on efficiency of real investment decisions Gao & Liang (2013); Han, Tang & Yang (2016).

An interesting dimension revealed by papers in this realm of work is that the type of information being disclosed is key in determining whether disclosure is desirable Bond & Goldstein (2015), Goldstein & Yang (2016).

Disclosure requirements, accounting and auditing standards should be in place and they should be of a high and internationally accepted quality. There must also be adequate legal protection for both debtors and creditors.

According to Goldstein & Yang (2017), stated that more public information can weaken the incentive of traders to become informed and/or to acquire precise information. In other words, public information crowds out the production of private information this can weaken and potentially reverse the direct effect of disclosure on some market quality variables. Full disclosure of information material to an investor's decision is the most important means for ensuring investor protection. Investors are thereby better able to assess the potential risks and rewards of their investment.

2.3 Conceptual framework

According to Artyom, Kan, Randall, and Bernard (2003), capital market is a direct and positive relation with capital allocation. Because stock price in efficient market moves significantly in unique patterns, signaling valuable insights into a company's investment worthiness. A frame of work is created for the study given to explore the link between financial market and capital allocation based on the aforementioned literature and its dimensions. As a result, the researcher created the conceptual framework below.

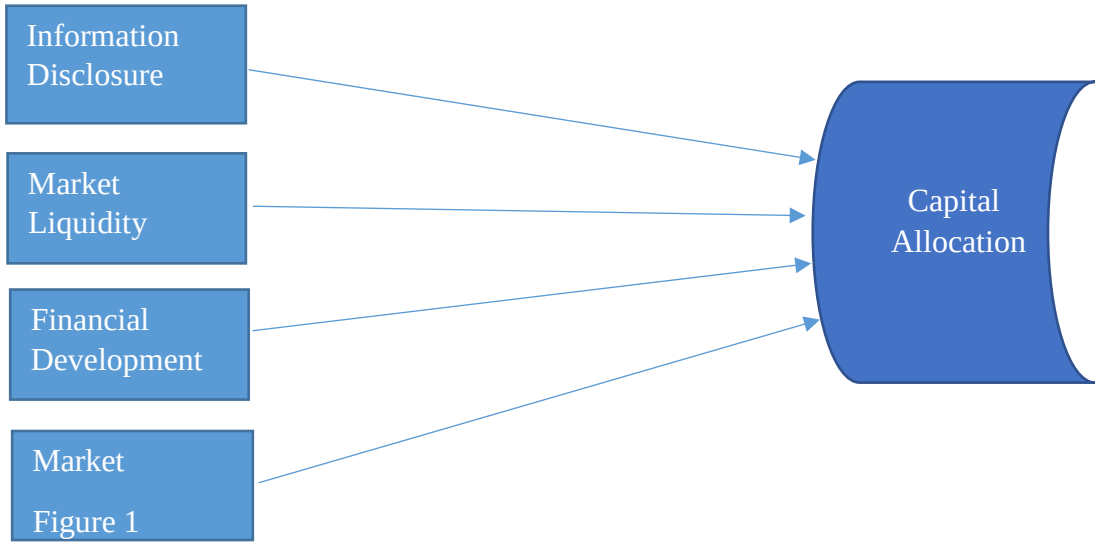

Figure 2:

Conceptual framework

CHAPTER THREE

3. METHODOLOGY OF THE RESEARCH

3.1 Introduction

According to Asfawossen (2022), research in simple term is searching or knowledge and searching or truth. In fact it is a systematic study of a problem attacking by a deliberately chosen strategy

which starts with choosing an approach to preparing blueprint (design) acting upon it in terms of designating research hypothesis, choosing methods and techniques, selecting and developing data collection tools, processing the data, interpretation and ends with presenting solutions to the problem Grover (2015).

3.2 Research Design

According to Bowerman and O' Connell (2003), the appropriate research method that can be employed is determined by the topic of the research. According to the idea explained for this topic it's suitable to use explanatory approach because it allows me to understand the complex relationships between different variables that impact capital allocation efficiency. To strengthen the idea Robson (2002), explanation research seeks to gain an explanation of a specific situation or problem, typically in the form of causal relationships. It is the blueprint for the collection, measurement, and analysis of data. Factors such as market liquidity, information disclosure, market volatility, investor participation, and institutional infrastructure all play a role in shaping how capital is allocated in the market. By delving deeply into these relationships, we can gain a more nuanced understanding of how these factors interact and influence capital allocation. Secondly, the explanatory approach helps in identifying causal relationships between various factors and capital allocation efficiency.

Through data analysis and empirical studies, we can determine which factors directly impact capital allocation efficiency and which are merely correlated. The empirical aspect of this study is essential as it provides concrete evidence and insights into the factors influencing capital allocation efficiency in the Ethiopian capital market. By analyzing data and conducting empirical studies, the study can identify key drivers of efficiency, distinguish between causal factors and correlations, and provide actionable recommendations for policymakers and market participants to prioritize areas for improvement in the capital market.

3.2.1 Definition of study variables in capital market indicators

Financial development

According to Worku (2022), financial development refers to an increase in the number of financial services and products provided by both financial institutions and financial markets. The policies, circumstances, and institutions that contributed to efficient intermediation and effective financial

markets. Financial development, according to the international monetary fund (2016), is a combination of market depth (market size and liquidity), access (individual and enterprise ability to get financial service), and efficiency (ability of institutions to provide financial service at low cost with sustainable revenues). Therefore I will use the financial development index as a measurement of financial development. Those are the financial market depth index, financial market access index, and financial market efficiency index.

Market depth index = market capitalization/ GDP

= Stoke traded/ GDP

= foreign debt securities of the government/ GDP

= total debt securities of financial and non-financial firms/ GDP

Market access index, which aggregates statistics on percent of market capitalization out of top ten largest firms and total number of debt issues per 100,000 individuals (domestic and external, nonfinancial and financial corporations).

Percent of Market Cap from Top Ten= (Market Cap of Top Ten Firms/Total Market Cap of All Firms) 100%

Total Number of Debt Issues per 100,000 Individuals= (total number of debt issuers/total population) 100,000

Market efficiency index, which aggregates information on stock market turnover ratios, is a useful tool (stock traded to market capitalization) source: IMF (2016).

Liquidity/Trade volume

Liquidity is the degree to which an asset or security can be bought or sold in the market without affecting the assets market price. In effect, how marketable it is, at a price that is stable and transparent. Liquidity is characterized by a high volume of trading activities. Those assets that can be easily bought and sold are liquid assets.

Liquidity is the ability to convert an asset or securities to cash quickly is also known as ‘’marketability’’. Liquidity is often also calculated by using liquidity ratios. On the side of

investors, liquidity is the main issue in actively participating in the market. To strengthen the idea Ruecker (2011) states that the primary focus of investors in the capital market is liquidity for any kind of transaction around the globe. Liquidity is the benchmark in measuring performance in the capital market.

Trade volume = monthly birr volume/ the sum of absolute value of daily percentage change in the stock market.

Information disclosure

Information disclosure refers to the process of making relevant information available to stakeholders, including investors, regulators, customers, employees, and the public. Disclosure of information in the financial market is at the forefront of regulatory efforts to improve financial market quality and stability Italy, G. and Liyan, Y. (2017). According to Urquiza, F. B., Navarro, M. C. A., Trombetta, M., & Lara, J. M. G. (2010) states that three indices are used to measure information disclosure based on the specificity of the information attributes captured (from simpler to more complex and detailed). The first and simple index that captures information quantity (quantity index). Second, given that capture of informational coverage (scope index). Third, which is claimed to be a proxy or disclosure quality (named quality index). The quantity index (QNI) measures the amount of information by taking into account the number of sentences with forward- looking information. QNI = (fl-min) / (max-min)

Where:

fl: is the number of sentences with forward-looking information disclosed by company i.

Max: is the maximum number of sentences with forward-looking information disclosed by the company.

Min: is the minimum number of sentences with forward-looking information disclosed by the company.

The quantity index ranges between 0 and 1.

Scope index (SCI) measures the value of the index for a particular company that is obtained by dividing the number of information items disclosed by the company to the total number of information disclosure items that may be disclosed.

SCI= the number of information items disclosed by the company / the total number of information disclosure items that may be disclosed.

Quality index (QLI) is obtained by taking the mean value of the above two indices. Those are relative quantity index and the coverage of information both in depth and width.

QLI= ½(RQI + RSI)

Market Volatility

Market volatility is the frequency and magnitude of price movements, up or down. The stock market never stays, however the magnitude and frequency have also differ. The bigger and more frequent the price swings, the more volatile the market is said to be.

Volatility= = $\sigma\sqrt{T}$

Where= Standard deviation of returns

T = number of periods in the time horizon

Table 1: list of criteria and sub criteria of capital market efficiencies.

Goals	criteria	Sub - criteria
	C2Tradingvolume /Liquidity/	TV = (monthly birr value) / (the sum of absolute value of daily percentage changes in stock price)
	C3 Market Volatility	volatility= $\sigma\sqrt{T}$
	C3Information disclosure	QNI = (fl-min) / (max-min)
		QLI= ½(RQI + RSI)

		SCI= the number of information items disclosed by the company / the total number of information disclosure items that may be disclosed
		MD1= market capitalization/ GDP
	C4Financial development	MD2= foreign debt securities of the government/ GDP
		MD3= total debt securities of financial and nonfinancial firms/ GDP
		Market access= total debt issuer per 100,000 individuals =Percent of Market Cap from Top Ten Firms
		Market efficiencies=Total stock traded/ average market capitalization

3.2.2 Definition of study variables capital allocation performance indicators

Profitability

Profitability refers to the company's capability of generating profit from its operations. In general profitability is defined as the earnings of a company that are generated from revenue after deducting all expenses incurred during a given period of time. It is one of the most important factors that signal management's success, shareholder's satisfaction, attraction for investors and

the company's sustainability Bekmezci (2015). In the context of stocks, profitability often refers to the company's ability to generate earnings or net income relative to its invested capital. Key metrics used to evaluate profitability include:

A, (ROI) Return on Investment (ROI): This measures the return generated on an investment relative to its cost.

$$ROI = (\text{Net Profit}/\text{Initial Investment}) \times 100\%$$

(B), Return on Equity (ROE): ROE measures a company's profitability. It is calculated by dividing net income by shareholders' equity.

$$ROE = (\text{Net Income}/\text{Shareholders' Equity}) \times 100\%$$

(C)Earnings per Share (EPS): EPS indicates a company's profitability on a per-share basis, calculated by dividing the company's net income by the total number of outstanding shares. EPS= Net Income/Weighted Average Number of Shares Outstanding

Growth

Growth typically refers to an increase in a country's Gross Domestic Product (GDP) over time. In financial markets, growth reflects the dynamic nature of the economy, investor behavior, technological advancements, and regulatory changes and it is also measured by rate of return (RoR). Rate of return is the net gain or loss of an investment over a specified time period, expressed as a percentage of the investment's initial cost. When calculating the rate of return, we are determining the percentage change from the beginning of the period until the end.

$$\text{Rate of return} = \text{Initial value } [(\text{Current value} - \text{Initial value})] \times 100$$

Table 2: list of criteria and sub criteria of capital allocation efficiencies

Goals	criteria	sub - criteria
	C1 profitability	ROI= (Net Profit/Initial Investment)×100%
		ROE= (Net Income/Shareholders' Equity)×100%

Capital allocation	Performance C2 Growth	EPS= Net Income/Weighted Average Number of Shares Outstanding
		RoR= Initial value(Current value−Initial value)]
		×100

3.3 Method of data collection

For this study, the researcher was used both only primary data collection systems. In order to obtain primary data, the researcher was used structured questionnaires. According to Yin (1989), structured questioners are important method for collecting primary data and that it further allows the researcher to be well focused on the specific research topic. Those questionnaires' that was designed to the respondents have direct and indirect participation in the capital market. The aim of those questionnaires is to get perspective about how the capital market of Ethiopia overcomes glorious changes in the financing sector and the economy as a whole by swift channeling of finance.

3.4 Sampling Technique

For this study purposive sampling technique would be used. Purposive sampling involves selecting participants based on specific criteria that are relevant to our research objective. In this case, the criteria could include individuals who have well known knowledge about the Ethiopian capital market, such as academicians, financial institutions, and consultants. It allowed the researcher to select participants who have direct knowledge or experience related to the research objective, so the sample could be representative of key stakeholders in that market.

For the research, the researcher made Addis Ababa as a sampling location. Addis Ababa, as the capital city of Ethiopia, plays a pivotal role in the country's economic landscape. It serves as the political and economic center, hosting key financial institutions, academicians, and a significant number of businesses and investors. Those unique status of Addis Ababa made the focal point for understanding Ethiopia's economic activity and the dynamics of its capital market.

3.5 Sample size determination

To ensure a comprehensive understanding of the Ethiopian capital market, the researcher take 384 individuals or the representative for unknown population those are academicians, individuals from financial institutions, and business consultants. This sample size is deemed sufficient to gather a diverse range of perspectives and insights from various sectors. Such as individuals from financial institutions can provide insight how the capital market can complement traditional financing methods: Challenges and opportunities for product development within the market: and regulatory changes needed to enhance market participation by financial institutions. Consultants also provide insights about the types of companies most likely to benefit from the capital market. And finally academicians told about the overall perspective gained from their academic achievement. According to Kothari (2004) an assessment of the normal extent of achievement should be achieved through the following formula. Confidence level (z): This is the probability that the sample results will fall within a certain range of the true population parameter. A higher confidence level requires a larger sample size. In this case, a 95% confidence level is used, which corresponds to a z-value of 1.96. Estimated proportion (p): This is the expected proportion of individuals in the population who possess the characteristic of interest. A conservative estimate of 50% is used here, as it maximizes the sample size needed. Margin of error (e): This is the maximum allowable difference between the sample estimate and the true population parameter. A smaller margin of error requires a larger sample size. In this case, a margin of error of 5% is chosen.

Where:

n = the sample size
Z = standard error associated with the chosen level of confidence (For 95% confidence = 1.96) e= acceptable sample error (0.05) p = probability of success (assume it is 0.5) n= $Z^2 (P (1-p)/e^2)$

n= (1.92) ² (0.5(1-0.5) ÷ (0.05) ²

n= 384

Therefore, the final sample size for this study is 384.

3.6 Data analysis

For this study the researcher was used Quantitative analysis: by using statistical methods such as regression analysis to analyze the relationship between, financial development, market liquidity, information disclosure, market volatility and capital allocation. The collected data were transferred to analyzing software called statistical package for social science (SPSS) version 24, and were analyzed by using explanatory analysis to show the finding process and provide insight and communicating that to the necessary decision makers and stakeholders in Ethiopian capital market.

3.7 Instrumental validity & Reliability

3.7.1 Instrumental validity

According to Mekdes (2020), validity refers to the extent to which the results obtained from data analysis accurately represent the phenomena being studied. It is not a fixed value but rather a matter of degree. To assess the validity of the instruments used in this study, a pilot study was conducted to refine the methodology and test tools, such as questionnaires, before the final phase of administration. Reviewing the questionnaires with experts were help eliminate redundancy and errors. Additionally, obtaining proper feedback and approval from my research advisor is crucial to ensure the instrument's validity. Finally, the revised version of the questionnaires were printed, duplicated, and distributed.

3.7.2 Instrumental reliability

Mekdes (2020) also states that, Reliability is the degree to which the data collection techniques and analytical procedure would reproduce consistent findings if it administered again. The test retest concept was applied to test its reliability.

3.8 Ethical consideration

Conducting this research every requirement of research ethics will be considered in order to establish trust with the participants and respect them as autonomous beings, thus enabling them to make a sound decision. From them ethics:

- Informed consent were obtained from all participants in the study.
- Confidentiality of data was maintained, and all data will be anonymized before analysis.

CHAPTER FOUR

4. RESULT AND DISCUSSION

4.1 Introduction

This section delves into the quantitative findings of the study, emphasizing the regression relationships between independent and dependent variables. Each variable is analyzed across various cross-sections, providing a comprehensive view of the results. Key components of this analysis include descriptive statistics, Pearson correlation coefficient assessments, tests for the

assumptions of the linear regression model, and the overall regression outcomes pertinent to the study's objectives.

4.2 Demographic Analysis

4.2.1 Demographic characteristics of respondents

This research encompasses essential demographic characteristics of the respondents, including gender, age groups, educational levels, and occupational backgrounds. Gender: This variable was examined to analyze differences in perceptions between male and female respondents. Age Groups: The age distribution of respondents was assessed to identify which age groups participated in the survey. Educational Level: This aspect was explored to understand the educational backgrounds of the respondents, providing insight into their qualifications and potential influences on their responses.

Overall, this demographic analysis serves to contextualize the quantitative results, offering valuable insights into the characteristics of the study's participants and how these may impact the findings.

Table 3: Gender profile of respondents, 2024.

		Frequency	Percent	Cumulative Percent
Valid	Female	137	38.6	38.6
	Male	218	61.4	100.0
	18-28	52	14.6	14.6
	29-38	138	38.9	53.5
	39-48	98	27.6	93.8
	49-60	67	18.9	100.0
	First degree	188	53.7	53.7

	Master's degree	147	42.0	95.7
	PHD and above	15	4.3	100.0
	Financial institutions	120	33.8	33.8
	Consultant's	67	18.9	42.7
	Academician's	168	47.3	100

Source: Own survey result, 2024.

Statistics

The Respondents profile based on table 4.1 describes that finding concerning the gender status with males constituting 61.4% and females making up 38.6%. The age group those aged 29-38, comprising nearly 39% of the total, and the age group of 39-48 years is 27.6% of the total, followed by 49-60 years comprising 18.9% of the total, and finally, the youngest group of 18-28 years is fulfilling 14.6% of the total. And also the educational background of the respondents, 53.7% of the respondent are first degree holders, , 42.0% of the total are categorized under master degree and 4.3% of the total are constituting doctorate holders. The data reveals a strong presence of professionals with at least a bachelor's degree, highlighting the importance of formal education in the perception capital markets. The educational background of professionals in the capital markets plays a significant role in shaping their expertise, decision-making abilities, and investment strategies. According to the occupational status of respondents, there are financial institutions, consultants, and academicians. From those Prevalence of Academicians is 47.3%, financial institutions also33.8% of the total, and 18.9% of those are consultants.

The respondent distribution highlights a diverse representation of stakeholders in the Ethiopian capital market, with a notable emphasis on academic perspectives. This balance between theoretical insights and practical financial experience is essential for fostering an environment conducive to effective capital allocation.

Table 7: Mean and standard deviation, 2024.

	N	Mean	Std. Deviation

Capital allocation	355	3.1127	1.13142
Information disclosure	355	3.0606	.81467
Financial development	355	3.0387	1.19973
Market liquidity	355	2.8725	1.27245
Market Volatility	355	2.8972	1.22113
Valid N (listwise)	355		

Source: Own survey result, 2024

The above table presents the mean and standard deviation for various factors influencing the capital allocation function in the emerging capital market of Ethiopian, based on responses from 355 participants. The survey results reveal varying levels of agreement on key factors affecting the capital allocation in emerging market. While capital allocation and information disclosure are viewed more positively, concerns about market liquidity and volatility warrant further investigation. Understanding these dynamics can help stakeholders develop strategies to enhance market efficiency and stability, ultimately supporting better capital allocation and economic growth in Ethiopia.

4.2.2 Information disclosure

The data clearly indicate that effective information disclosure is vital for improving capital allocation in the Ethiopian capital market. Reliable, transparent, and timely information not only reduces investment risks but also fosters investor confidence and encourages informed decision-making. The highest mean score of 1.86 for the statement that information disclosure practices facilitate capital allocation reflects a strong consensus on the role of transparency in directing resources efficiently within the market. This suggests that improved disclosure practices can lead to better alignment of capital with productive investments. The mean score of 1.43 for the statement about available and transparent information underscores its significance in enhancing investment decisions. This indicates that transparency is viewed as a fundamental component for effective capital allocation, as it allows investors to evaluate opportunities more accurately. To enhance capital allocation, stakeholders should focus on improving disclosure practices, considering both traditional and alternative information sources, to create a more robust investment environment. This, in turn, can lead to better resource allocation and support economic growth in Ethiopia.

Table 8: Mean and standard deviation of Information disclosure, 2024.

Information disclosure	Mean	Std. Deviation
Access to reliable information could reduce overall investment risk.	1.40	.683
Alternative information sources can improve limitations in company disclosures.	1.23	.567
Available and transparent information improve investment decisions.	1.43	.635
Information disclosure practice facilitate capital allocation.	1.86	1.170
Provision of timely and accurate information	1.34	.556
Boost investors' confidence.		

Source: Own survey result, 2024

4.2.3 Financial development

The survey results emphasize that financial development plays a significant role in enhancing capital allocation efficiency within the market. Key factors such as market depth with mean score of 1.44 reflects a strong belief that this factor is indicative of the overall health of the financial market. This suggests that respondents view a deeper market as essential for stability and resilience, which can facilitate better capital allocation. Efficiency in Allocation with am mean of 1.41 indicating that financial development leads to improved allocation efficiency, respondents recognize the importance of developing financial systems to enhance how resources are allocated. This underscores the role of robust financial institutions and infrastructure in optimizing capital distribution. Diverse financial instruments, and overall financial system robustness contribute to more effective resource distribution and smarter capital flows. Stakeholders should focus on

fostering financial development through improved infrastructure and a wider array of financial products to optimize capital allocation and support economic growth.

Table 9: Mean and standard deviation of financial development, 2024.

Financial development	Mean	Std. Deviation
Market depth indicate the overall health of financial market.	1.44	1.057
Financial development leads to improved allocation efficiency.	1.41	.596
Diverse financial instruments drive smarter capital flow.	1.25	.664
Optimal distribution of capital resources enact through developed market.	1.17	.519

Source: Own survey result, 2024

4.2.4 Market Liquidity

The survey results on market liquidity reveal critical insights into how liquidity influences capital allocation and investment decisions. The highest mean score of 1.41 in facilitating the provision of capital indicates strong agreement that liquid markets facilitate the provision of capital flow. This reflects a consensus among respondents that liquidity is vital for ensuring that capital can move freely within the market, which is essential for investment and economic growth The survey results underscore the critical role of market liquidity in enhancing capital allocation and influencing investment decisions. Key aspects such as the provision of capital flow and the creation of market depth are seen as paramount, while the accurate reflection of asset values and swift transactions with the mean score of 1.18 and 1.19 may be considered secondary priorities respectively. Overall, fostering market liquidity should be a focus for stakeholders aiming to improve market efficiency and investment outcomes.

Table 10: Mean and standard deviation of capital allocation, 2024.

Market liquidity	Mean	Std. Deviation
Liquid market provide the creation of adequate market depth.	1.27	.637
Liquid Market leads to improved capital allocation.	1.26	.572
Liquid market provide fair and accurate reflection of asset value.	1.18	.536
Liquid Market facilitate the provision of capital flow.	1.41	.941

Liquid market facilitate swift transactions of assets.	1.19	.456
Market liquidity is a crucial factor in my investment decisions.	1.35	.702

Source: Own survey result, 2024

4.2.5 Market Volatility

The survey results highlight the nuanced relationship between market volatility and investment behavior. Respondents recognize the potential benefits of portfolio rebalancing as a strategy to mitigate volatility's impact with the mean score of 1.21 indicates a general agreement that portfolio rebalancing can help mitigate the effects of market volatility. This suggests that respondents recognize the importance of adjusting their portfolios in response to changing market conditions to manage risk effectively, while also acknowledging the challenges posed by high price fluctuations and excessive risk aversion with a mean score of 1.14. Overall, these findings suggest that while caution is warranted during volatile periods, a balanced approach that includes strategic rebalancing may help investors navigate market uncertainties more effectively and seize opportunities for growth.

Table 11: Mean and standard deviation of market volatility, 2024.

Market Volatility	**Mean**	**Std. Deviation**
Portfolio rebalancing mitigate the impact of market volatility.	1.21	.499

Market volatility can lead to missed investment opportunities for risk-averse investors.	1.14	.430
High price fluctuations could hinder investment decisions.	1.14	.433
Excessive risk aversion during volatile times can limit investment opportunities.	1.12	.459

Source: Own survey result, 2024

4.2.6 Capital allocation

This shows that overall significance of capital allocation's effectiveness and its role in productivity, innovation, or economic growth. However the standard deviations indicate varying levels of agreement among respondents, with some statements showing more consensus than others. These results could imply a need for further exploration into why respondents hold these views and whether they reflect a broader skepticism about capital allocation mechanisms or specific contexts in which these mechanisms operate.

Table 12: Mean and standard deviation of capital allocation, 2024.

Capital allocation	Mean	Std. Deviation
Smart Allocation b Boosts Productivity and Innovation.	1.30	.511
Capital redistribution and reallocation achieved Through allocation function.	1.33	.652
Capital allocation is a critical driver for Economic growth and development.	1.17	.438
Capital market channel financial Resources Toward their most productive uses.	1.23	.522
Asset allocation have determined by market Conditions.	1.26	.513

Source: Own survey result, 2024

4.3 Correlation between capital allocation and predictors

The table presents the results of a Pearson correlation analysis, which evaluates the relationships between independent variables and the dependent variable, capital allocation function. The findings indicate that while there are notable correlations among the independent variables—particularly between market liquidity and financial development—these do not significantly undermine the integrity of the regression model. Correlation is a statistical measure that quantifies the degree of linear relationship between two variables, with values ranging from -1 to 1. A correlation coefficient of -1 signifies a perfect negative correlation, where one variable increases as the other decreases. Conversely, a coefficient of 1 indicates a perfect positive correlation, where both variables move in the same direction. A coefficient of 0 suggests no linear relationship exists between the variables. In this analysis, we observed a strong positive correlation of 0.829 between the dependent variable, capital allocation function, and financial development. This suggests a robust link between these two variables, implying that improvements in financial development are associated with enhanced capital allocation.

Similarly, information disclosure practices exhibit a strong positive correlation of 0.722 with capital allocation function, indicating that better information transparency contributes to increased capital utilization. Other independent variables also show significant positive correlations with the capital allocation function: protection (0.715), market liquidity (0.736), and market volatility (0.609). These relationships further underscore the interconnectedness of these factors in influencing capital allocation decisions.

Overall, while some correlations exist among the independent variables, they do not detract from the model's validity, allowing for meaningful interpretations of the regression results.

Table 13: Correlation between capital allocation and predictors, 2024.

	Capital allocation	Financial development	Information disclosure	Market Liquidity	Market volatility
Capital allocation	1				
Financial	.829**	1			
development					
Information disclosure	.722**	.723**	1		
Market liquidity	.736**	.759**	.631**	1	
Market volatility	.609**	.618**	.553**	.675**	1

Source: Own survey result, 2024.

**Correlation is significant at the 0.01 level (2-tailed).

4.4 Multiple liner regression

4.4.1 Model assumptions for multiple regression:

Multicollinearity: Multicollinearity occurs when two or more predictor variables in a regression model are highly correlated, which can complicate the interpretation of the model coefficients. To assess the presence of multicollinearity, we examined the variance inflation factor (VIF) values for all predictors. The VIF values were found to be below 10, suggesting that multicollinearity is not a significant issue in this analysis. Additionally, we analyzed the correlation matrix of the predictors. The correlation coefficients between all pairs of predictors were below 0.80, indicating that no pairs of predictors are excessively correlated. This reinforces our confidence in the integrity of our model.

As a result of these findings—specifically, the acceptable VIF values and low correlation coefficients—we can conclude that multicollinearity is not a concern in this study. This allows us to proceed with confidence in the validity of the regression coefficients and their interpretations.

Table 14: Multicollinearity Test, 2024.

	Model	Tolerance	VIF
	(Constant)	-	-
	Financial development	. 316	3.165
	Information disclosure	. 451	2.217
	Market liquidity	. 355	2.817
	Market volatility	. 512	1.952

Source: Own survey result, 2024

Homoscedasticity: The variance of the residuals should be consistent across all levels of the predictor variables. In simpler terms, homoscedasticity means that the residuals for each level of the predictors should exhibit the same variance. Conversely, heteroscedasticity refers to significant differences in variances. As shown in the figure below, the points are evenly and randomly spread across the plot. This distribution suggests that the assumptions of homoscedasticity have been met, as the variance at each point appears to be randomly distributed.

Linearity: For every unit increase in the predictor variables, the mean values of the outcome variable should ideally align along a straight line. This observation underscores the foundational assumption that the relationship we are attempting to model is linear in nature. If we were to apply a linear model to a relationship that is inherently non-linear, it would significantly restrict the generalizability of our findings. In other words, the conclusions drawn from such a model would not accurately reflect the true dynamics of the data, leading to potentially misleading interpretations.

To assess whether this linearity assumption holds true, the researcher employed a scatter plot. This visualization tool allows for a clear examination of the relationship between the predicted values and the standardized residuals. By plotting these two variables against each other, the researcher can visually inspect any patterns or deviations that may indicate a departure from linearity. If the points in the scatter plot exhibit a random distribution without discernible patterns, it supports the notion that a linear model is appropriate for the data. Conversely, if distinct trends or shapes emerge, it may suggest that a non-linear modeling approach would be more suitable.

4.4.2 Multicollinearity Considerations:

While there are some signs of multicollinearity (especially for financial development and market liquidity), none of the VIF values exceed common thresholds (e.g., >10). Therefore, multicollinearity is unlikely to severely impact the results.

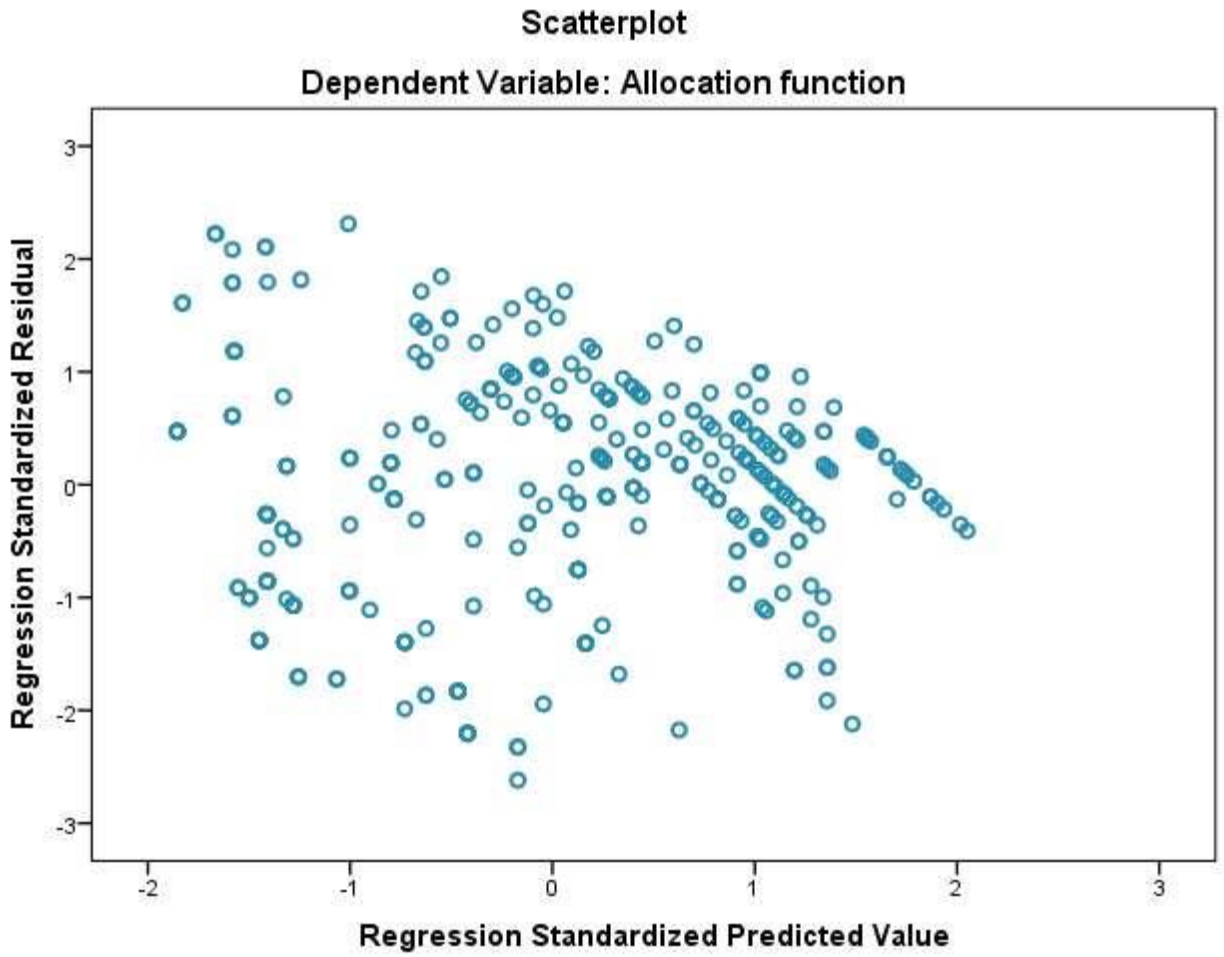

Figure 3: Scatter plot that shows heteroscedasticity and linearity, 2024.

Normality: The model's residuals are assumed to be random variables with a mean of 0 and a normal distribution. This assumption implies that large discrepancies from zero are uncommon, and typically, the model's predictions and the observed data differ by zero or only a small amount. To assess the distribution of the data, the researcher utilized a histogram and a normal probability plot. The results indicate that the distribution is approximately normal, with a slight deficiency of residuals exactly at zero, suggesting that the data is only marginally deviating from normality. Therefore, the assumption fulfilled. (Fig 3).

To assess normality in a dataset based on regression results or any statistical analysis, we typically use several methods. However, based on the actual data or a figure analyze here, I can explain through the common approaches to check normality or this data.

Histogram: Plot a histogram of the residuals (the differences between observed and predicted values). It shows a bell-shaped curve indicates that normality.

Q-Q Plot (Quantile-Quantile Plot): This plot shows the quantiles of the residuals against the quantiles of a normal distribution. If the points fall approximately along a straight line, the residuals are normally distributed.

Skewness: Measures the asymmetry of the distribution. A skewness close to 0 suggests symmetry (normal distribution).

Kurtosis: Measures the "tailedness" of the distribution. A kurtosis close to 3 indicates a normal distribution.

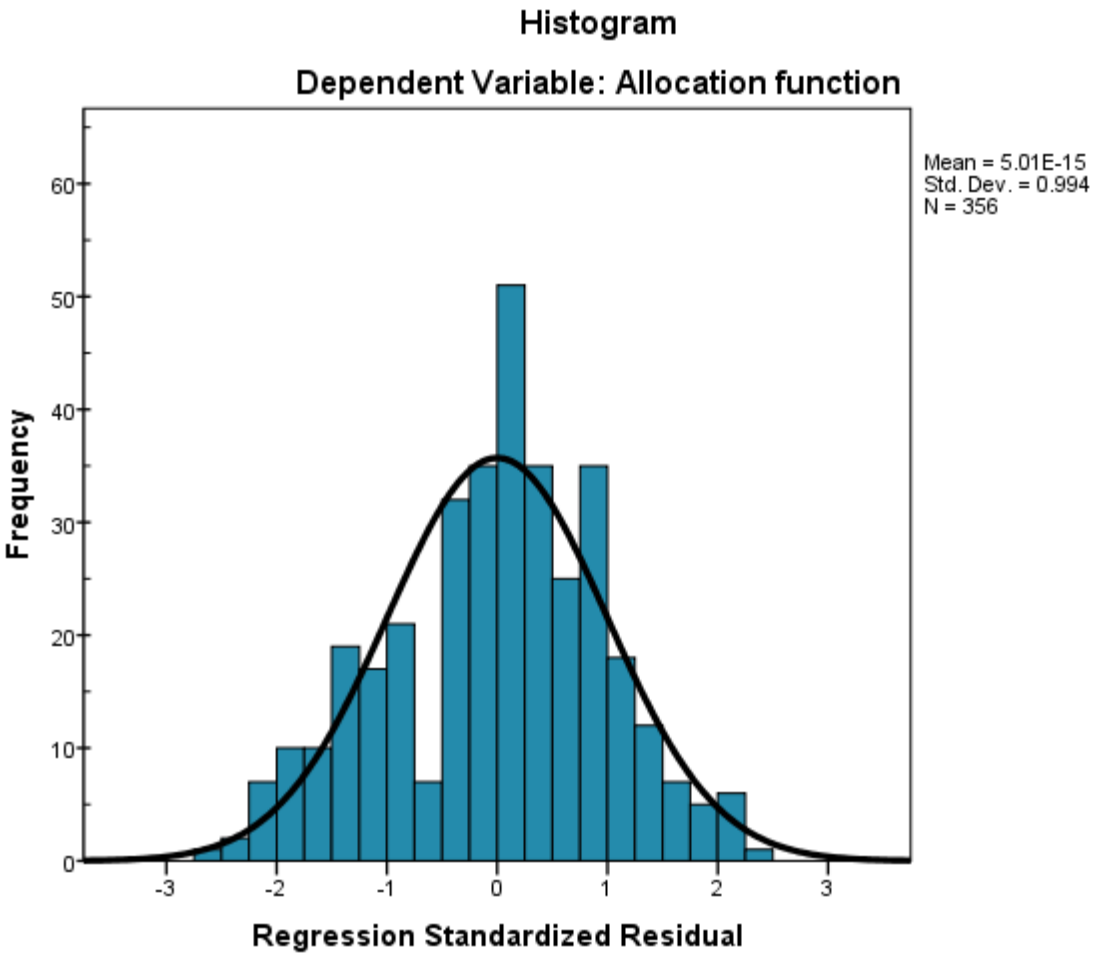

Figure 4: plot of histogram, 2024.

For every unit increase in the predictor variables, the mean values of the outcome variable should ideally align along a straight line. This observation underscores the foundational assumption that the relationship we are attempting to model is linear in nature. If we were to apply a linear model to a relationship that is inherently non-linear, it would significantly restrict the generalizability of our findings. In other words, the conclusions drawn from such a model would not accurately reflect the true dynamics of the data, leading to potentially misleading interpretations.

To assess whether this linearity assumption holds true, the researcher employed a scatter plot. This visualization tool allows for a clear examination of the relationship between the predicted values and the standardized residuals. By plotting these two variables against each other, the researcher can visually inspect any patterns or deviations that may indicate a departure from linearity. If the points in the scatter plot exhibit a random distribution without discernible patterns, it supports the notion that a linear model is appropriate for the data. Conversely, if distinct trends or shapes emerge, it may suggest that a non-linear modeling approach would be more suitable.

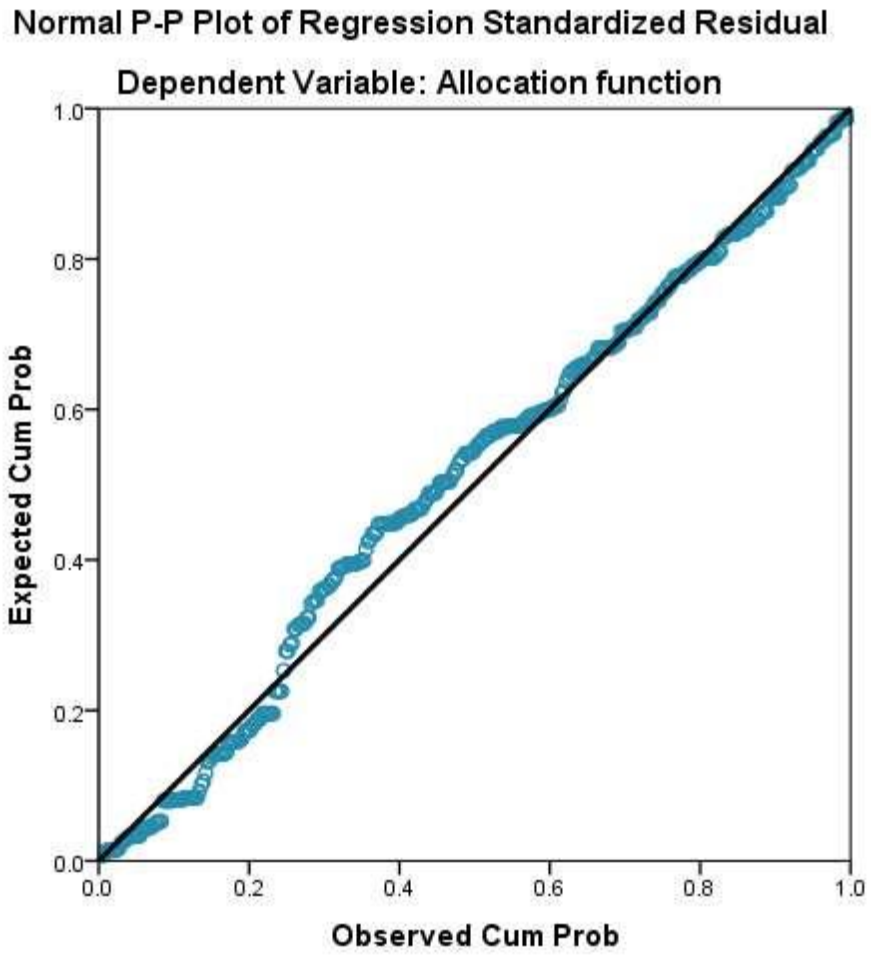

Figure 5: Normal P-P plot of regression, 2024.

Source: Own survey result, 2024

If the points on the plot closely follow a straight diagonal line, it suggests that the residuals are normally distributed. Deviations from this line indicate departures from normality. Specific Observations in the above Plot: Based on the above figure described, the points generally follow a straight diagonal line, it's a good sign that the residuals are normally distributed.

4.4.3 Model of fitness:

Table 15: Normal P-P plot of regression, 2024.

Model Summary[b]				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.871[a]	.759	.756	.561295
a. Predictors: (Constant), Market Volatility, Information dissemination, Market liquidity, Financial development.				
b. Dependent Variable: Capital Allocation function				

Source: Own survey result, 2024.

The R value and the R square values are shown in the model summary table above. The R value, which indicates a high level of correlation and is (0.871), represents the simple correlation. The proportion of the total variation in the dependent variable that can be explained by the independent variable is shown by the R square value, which is (0.759). This means that 75.9 percent, or the 75.9% change in capital allocation, could be attributed to the combined effects of the predictor variables stated above.

Table 16: ANOVA for model fitness, 2024.

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	346.446	4	86.611	274.952	.000[b]
	Residual	110.252	350	.315		
	Total	456.698	354			
a. Dependent Variable: Capital allocation function						
b. Predictors: (Constant), Market Volatility, Information dissemination, Market liquidity, Financial development						

Source: Own survey result, 2024.

In linear regression, ANOVA can tell us if using the mean as a "best guess" is better than using the model to predict the outcome. The F-ratio, in particular, is the ratio of the improvement in

prediction that comes from fitting the model to the model's remaining inaccuracy. As a result, the ANOVA table that follows demonstrates that the dependent variable and the independent variables differ significantly. The study's F-value (274.952): This value indicates the ratio of explained variance to unexplained variance. A higher F-statistic suggests that the model explains a significant amount of variance in the dependent variable relative to the error variance.

Regression (4): The number of predictors in the model (including the constant).

Residual (350): The total number of observations minus the number of parameters estimated (n - k).

Total (354): The total number of observations minus 1 (n - 1).

Regression (346.446): This indicates the total variation explained by the model.

Residual (110.252): This indicates the total variation that remains unexplained after fitting the model.

Total (456.698): This is the sum of the regression and residual sums of squares.

Significance (Sig.): p-value (.000): This indicates that the results are statistically significant at any conventional alpha level (e.g., 0.05, 0.01). A p-value of .000 suggests strong evidence against the null hypothesis, meaning that at least one predictor variable significantly contributes to explaining variance in the allocation function.

Regression Analysis

Table 17: Multiple linear regression of capital allocation, and predictors, 2024.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.125	.117		1.074	.284
	Financial development	.469	.046	.497	10.292	.000
	Information disclosure	.310	.056	.224	5.497	.000
	Market Liquidity	.157	.041	.177	3.786	.000
	Market Volatility	.057	.036	.061	1.582	.114

Source: Own survey result, 2024

4.5 Hypothesis test

The research hypothesis was examined more thoroughly and precisely using the regression analysis of the results shown in the preceding tables. Based on the standardized coefficient (beta value) and P-value, these hypotheses were tested using the model's regression results to determine whether the hypothesis was accepted or rejected.

H1: Financial development has positive and significant effect on Capital allocation function.

Based on the multiple linear regression conducted on this research, financial development has a positive and significant effect on capital allocation function. Thus, a one unit increase in financial development is associated with a 0. .469 unit (46.9%) o increase in capital allocation function (β1 = 0. 469, P< 0.001). Since the p-value is less than the significance level (usually 0.05), we reject the null hypothesis (Ho) and accept the alternative hypothesis (H1). This implies that the p-value of .000 confirms that the differences in means across the groups are statistically significant.

Implications: Financial development could be influenced by various factors such as policy changes, economic conditions, or institutional frameworks. The significant variance suggests that interventions or strategies aimed at enhancing financial development may need to be tailored to specific groups or contexts.

H2: Information disclosure has positive and significant effect on Capital allocation function.

The significant F-value suggests that differences in information dissemination practices or effectiveness across groups are substantial. The p-value confirms statistical significance. For every one unit increase in information dissemination Practice in the market leads to Capital allocation efficiency is expected to increase by 0.310 units (31%) ($\beta 2 = 0.310$, $P < 0.001$). Again, the p-value is less than the significance level, leading us to reject null hypothesis (H0) and accept the alternative (H1). This indicates that information dissemination practices has a positive and significant effect on capital allocation.

Implications: Effective information dissemination is critical for informed decision-making in financial markets. Variations in this aspect could lead to unequal opportunities for investors. In case policymakers might focus on enhancing communication channels and transparency to ensure all groups have access to relevant information.

H3: Market liquidity has positive and significant effect on Capital allocation function.

For market liquidity, the coefficient ($\beta 3$ is 0.157and a p-value of 0.000, thus, for every unit increases in market liquidity of the capital market, the capital allocation unction will raise by 0.157 unit (15.7%). Since the p-value is less than the significance level, leading us to reject null hypothesis (H0) and accept the alternative (H1), suggesting that market liquidity has a positive and significant effect on capital allocation function. The F-value indicates a moderate to strong effect of group differences on market liquidity. The p-value reinforces that these differences are statistically significant.

Implications:

Market liquidity is crucial for efficient market functioning. The differences could suggest varying levels of access to liquidity across groups, which may affect trading efficiency and price discovery.

H3: Market Volatility has positive and significant effect on Capital allocation function.

Regarding Market Volatility, the coefficient (β4) is -0.057 and a p-value of 0.114. Here, the pvalue is greater than the significance level, leading us to fail reject null hypothesis (H0). This indicates that market volatility does not have a significant effect on capital allocation. This means that improvements in market volatility may not directly influence Capital allocation function. However, it is important to note that Understanding the factors contributing to market volatility across different groups can help in risk management and investment strategies. Stakeholders might consider implementing measures to stabilize markets that exhibit higher volatility, potentially improving investor confidence and participation.

Table 18: Summary of Hypothesis Test.

Alternative Hypothesis	**Hypothesis**	**Statistical Result**	**Remark**
(H1)	Financial development has positive and significant effect on Capital allocation	β1 = 0.469 p=0.000	Supported
(H2)	Information disclosure has positive and significant effect on Capital allocation	β2 = 0.310 p=0.000	Supported
(H3)	Market liquidity has positive and significant effect on Capital allocation	β3 = 0.157 p=0.000	Supported
(H4)	Market volatility has positive and significant effect on Capital allocation	β4 = -0.057 p=0.114	Rejected

Source: Own survey result, 2024.

4.6 Discussion and Summary of Findings:

The ANOVA results indicate that there are significant differences among the means of the groups for all four variables: Financial Development, Market Liquidity, Market Volatility, and Information Dissemination. Statistical Significance: The consistent p-values of .000 across all variables suggest that the observed differences are unlikely to be due to random chance. Each variable has important implications for policymakers, investors, and market participants. For

example, enhancing financial development and liquidity can lead to more stable and efficient markets. Understanding the dynamics of market volatility can aid in better risk management practices, while improved information dissemination can promote transparency and fairness in the capital allocation.

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1 Summary of Finding

The main goal of the studies was to examine the role of emerging capital market on capital allocation function. Accordingly this part of the research summarizes the major findings of the study.

The respondent distribution highlights a diverse representation of stakeholders in the Ethiopian capital market, the age distribution among individuals involved in capital markets provides insights into the demographic trends that influence investment behaviors, risk tolerance, and decision-making processes, with a notable emphasis on academic perspectives. This balance between theoretical insights and practical financial experience is essential for fostering an environment conducive to effective capital allocation. Engaging all three groups—academicians, financial institutions, and consultants—will be vital for addressing the challenges faced by the capital market and ensuring sustainable economic growth in Ethiopia.

Based on the data reveals a strong presence of professionals with at least a bachelor's degree, highlighting the importance of formal education in the capital markets. As the market continues to evolve, fostering a workforce equipped with both foundational and advanced knowledge will be essential for optimizing resource distribution and supporting sustainable economic growth. Enhancing educational opportunities and promoting continuous professional development will further strengthen the capacity of Ethiopia's capital market to fulfill its vital role in capital allocation.

Further to measure capital allocation efficiency the study calculate mean and standard deviation of responses. Accordingly out of the study variables the finding reveals that except or market liquidity

all variables (i.e. Financial development, information dissemination, and market liquidity are significant predictors of the capital allocation function, indicating that improvements in these areas could enhance allocation efficiency).

In overall, the results of the study the regression result indicates except market volatility all the stated predicted variable have a positive and significant effect on capital allocation function and Market volatility does not significantly affect the allocation function in this model, suggesting that its role may be less critical compared to the other factors.

. Beside From the R square value it is depicted that, the total variation in the dependent variable that can be explained by the independent variable is shown by the R square value, which is (0.759). This means that 75.9 percent, or the 75.9% change in capital allocation, could be attributed to the combined effects of the predictor (i.e. financial development, information dissemination, and market liquidity) and other unexplored variables may explain the variation in capital allocation unction which accounts for about 24.1%.

5.2 Conclusion

Financial development, information dissemination, market liquidity, and market volatility were all examined in the study to see how they affected capital allocation unction.

Based on descriptive data, Stakeholders should prioritize financial development initiatives and improve information dissemination strategies to enhance allocation functions in their respective contexts. Monitoring and managing market liquidity can also contribute positively to allocation efficiency.

According to the findings, financial development, information dissemination, and market liquidity have a positive and significant effect on affected capital allocation function. This implies that, financial development place a high value on effective capital allocation, and that improvements in these areas may raise allocation efficiency. Additionally, it was discovered that information discovery had a positive and significant effect on capital allocation, underscoring the significance of putting in place reliable, transparent, and timely information not only reduces investment risks but also fosters investor confidence and encourages informed decision-making.

Additionally, it was discovered that the critical role of market liquidity in enhancing capital allocation and influencing investment decisions. Key aspects such as the provision of capital flow and the creation of market depth are seen as paramount, while the accurate reflection of asset values and swift transactions are acknowledged but may be considered secondary priorities.

However, the study could not identify any appreciable effect of market volatility on capital allocation unction. Despite the fact that being acknowledging the challenges posed by high price fluctuations and excessive risk aversion. Overall, these findings suggest that while caution is warranted during volatile periods, a balanced approach that includes strategic rebalancing may help investors navigate market uncertainties more effectively and seize opportunities for growth.

The regression model is statistically significant, as indicated by the very low p-value (.000). This suggests that at least one of the independent variables (Market Volatility, Information Dissemination, Market Liquidity, and Financial Development) has a significant effect on the allocation function.

5.3 Recommendation

Based on the conclusions the following recommendations can be made to enhance capital allocation function.

- It is essential to concentrate on enhancing the financial development based on the current study finding to increase capital optimization. Key factors such as market depth, diverse financial instruments, and overall financial system robustness contribute to more effective resource distribution and smarter capital flows. Stakeholders should focus on fostering financial development through improved infrastructure and a wider array of financial products to optimize capital allocation and support economic growth.
- The finding of this study clearly indicate that effective information disclosure is vital for improving capital allocation in the Ethiopian capital market. Reliable, transparent, and timely information not only reduces investment risks but also fosters investor confidence and encourages informed decision-making. To enhance capital allocation, stakeholders should focus on improving disclosure practices, considering both traditional and alternative

information sources, to create a more robust investment environment. This, in turn, can lead to better resource allocation and support economic growth in Ethiopia.

- Market liquidity also underscore the critical role in shaping various aspects of market function and investment behavior. Respondents generally agree that liquidity is essential for creating market depth, improving capital allocation, and facilitating capital flow, which are all crucial for investment efficiency and economic growth. While the reflection of asset value and swift transactions are acknowledged, they appear to be secondary to the overarching importance of liquidity in driving effective market dynamics and informed investment decisions.
- According to Market volatility, the potential benefits of portfolio rebalancing as a strategy to mitigate volatility's impact, while also acknowledging the challenges posed by high price fluctuations and excessive risk aversion. Overall, these findings suggest that while caution is warranted during volatile periods, a balanced approach that includes strategic rebalancing may help investors navigate market uncertainties more effectively and seize opportunities for growth.

5.4 Limitations and Direction of Future Research

In summery 75.9% change in capital allocation could be attributed to the combined effects of predictor variables, as finding shows that all independent variables that were statistically found to be significant and hypothesized variables express the model. However, another factor that was not included in the study accounts for 24.1% of the variance. As a result, the researcher suggest that a different researcher conduct on the area, which was not included in this study.

. Further studies could explore causal relationships and consider additional variables or interactions that may impact the capital allocation function. Investigating other contexts or sectors may provide broader insights into these dynamics. Qualitative research could complement these findings by exploring the underlying factors contributing to these differences.

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Annex

Part I

General instructions

- Leave off the name and address.
- Try to submit relevant responses in the space provided.
- Finally, I can assure you in confidence that providing accurate and useful facts won't affect your personality or work (business activity).

Thank you for your cooperation !!

Denekew Aderaw

Email: denekewaderaw0@gmail.com

Mob: +251931888669

Please put right mark **(√)** in front of your choice box that express yourself

1) Gender: Male □ Female □
2) Age: 18-28 □ 29-38 □ 39-48□ 49-60 □
3) Educational Status : University degree □ Master Degree PHD □
4) Occupational Status: Academicians □ Financial Institutions □ consultants

Part II

Questions regarding the role of the emerging Ethiopian capital market in facilitating capital allocation.

Below are a list of questionnaires relating to the role of the emerging Ethiopian capital market in facilitating capital allocation.

Surveys with closed-ended questions

S.N	**description**	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree
1	**Information disclosure**	1	2	3	4	5
1.1	Information dissemination practice facilitate capital allocation.					
1.2	Provision of timely and accurate information boost investors' confidence.					
1.3	Alternative information sources can improve limitations in company disclosures.					
1.4	Available and transparent information improve investment decisions.					
1.5	Access to reliable information could reduce overall investment risk.					
2	**Market liquidity**					
2.1	Liquid market facilitate the provision of capital flow.					
2.2	Liquid Market leads to improved capital allocation.					
2.3	Market liquidity is a crucial factor in my investment decisions.					
2.4	Liquid market provide the creation of adequate market depth.					

2.5	Liquid market provide fair and accurate reflection of asset value.					
2.6	Liquid market facilitate swift transactions of assets.					
	Financial development					
3.1	Financial development leads to improved allocation efficiency.					
3.2	Market depth indicate the overall health of a financial market.					
3.3	Diverse financial instruments drive smarter capital flow.					
3.4	Optimal distribution of capital resources enact through developed market.					
	Market volatility					
4.1	High price fluctuations could hinder investment decision.					
4.2	Market volatility can lead to missed investment opportunities for risk-averse investors.					
4.3	Portfolio rebalancing mitigate the impact of market volatility.					

4.4	Excessive risk aversion during volatile times can limit investment opportunities.					
4	**Capital allocation function**					
5.1	Capital market channel financial resources towards their most productive uses.					
5.2	Capital redistribution and reallocation achieved through allocation function.					
5.3	Capital allocation is a critical driver for economic growth and development.					
5.4	Smart allocation boosts productivity and innovation.					

		Allocation function	Financial development	Information dissemination	Market liquidity
Allocation function	Pearson Correlation	1	.828**	.723**	.731**
	Sig. (2-tailed)		.000	.000	.000
	N	356	356	356	356
Financial development	Pearson Correlation	.828**	1	.725**	.759**
	Sig. (2-tailed)	.000		.000	.000
	N	356	356	356	356
Information dissemination	Pearson Correlation	.723**	.725**	1	.625**
	Sig. (2-tailed)	.000	.000		.000
	N	356	356	356	356
Market liquidity	Pearson Correlation	.731**	.759**	.625**	1
	Sig. (2-tailed)	.000	.000	.000	

market Volatility	N Pearson Correlation	.610**	.616**	.555**	.670**

Part III

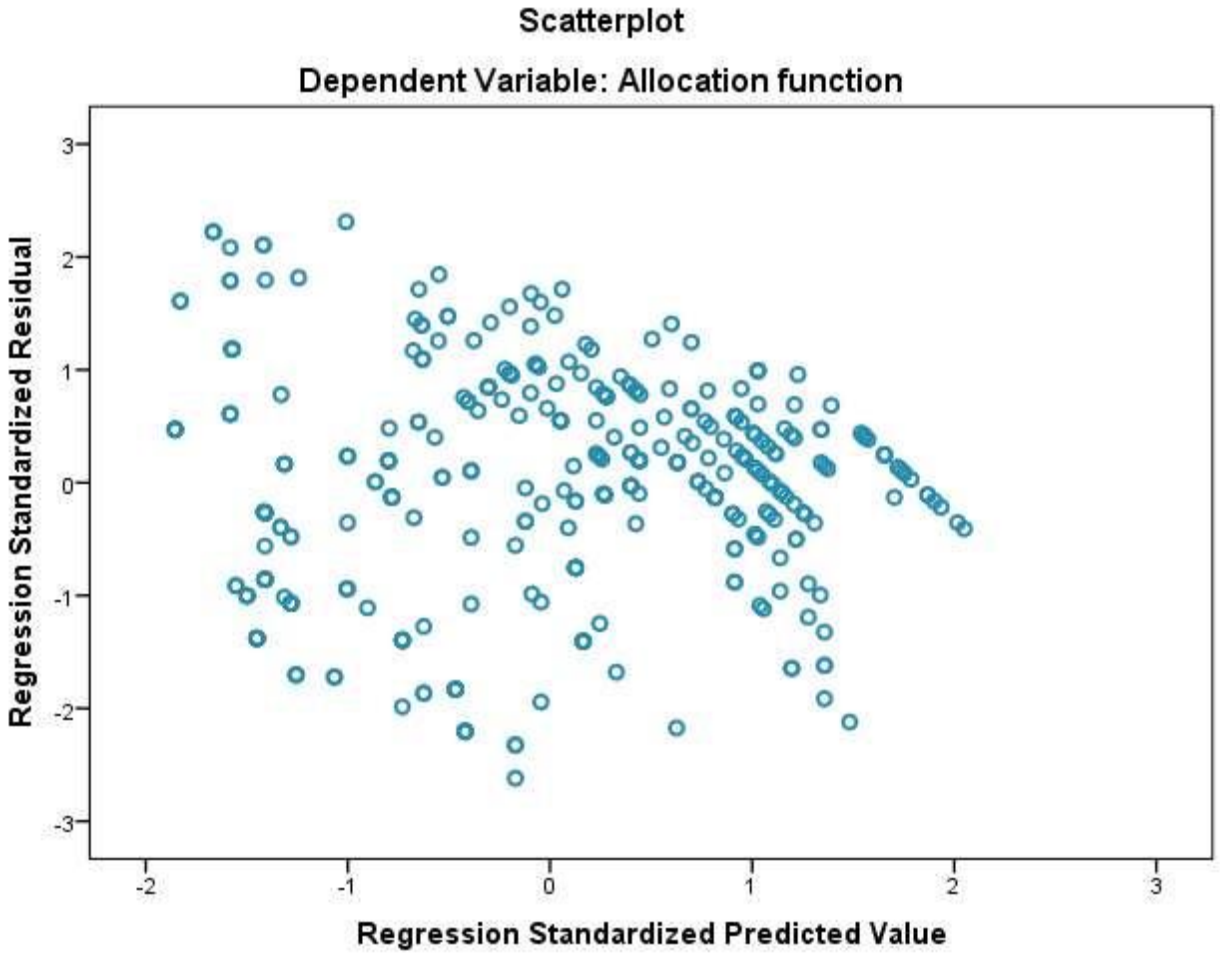
Correlations

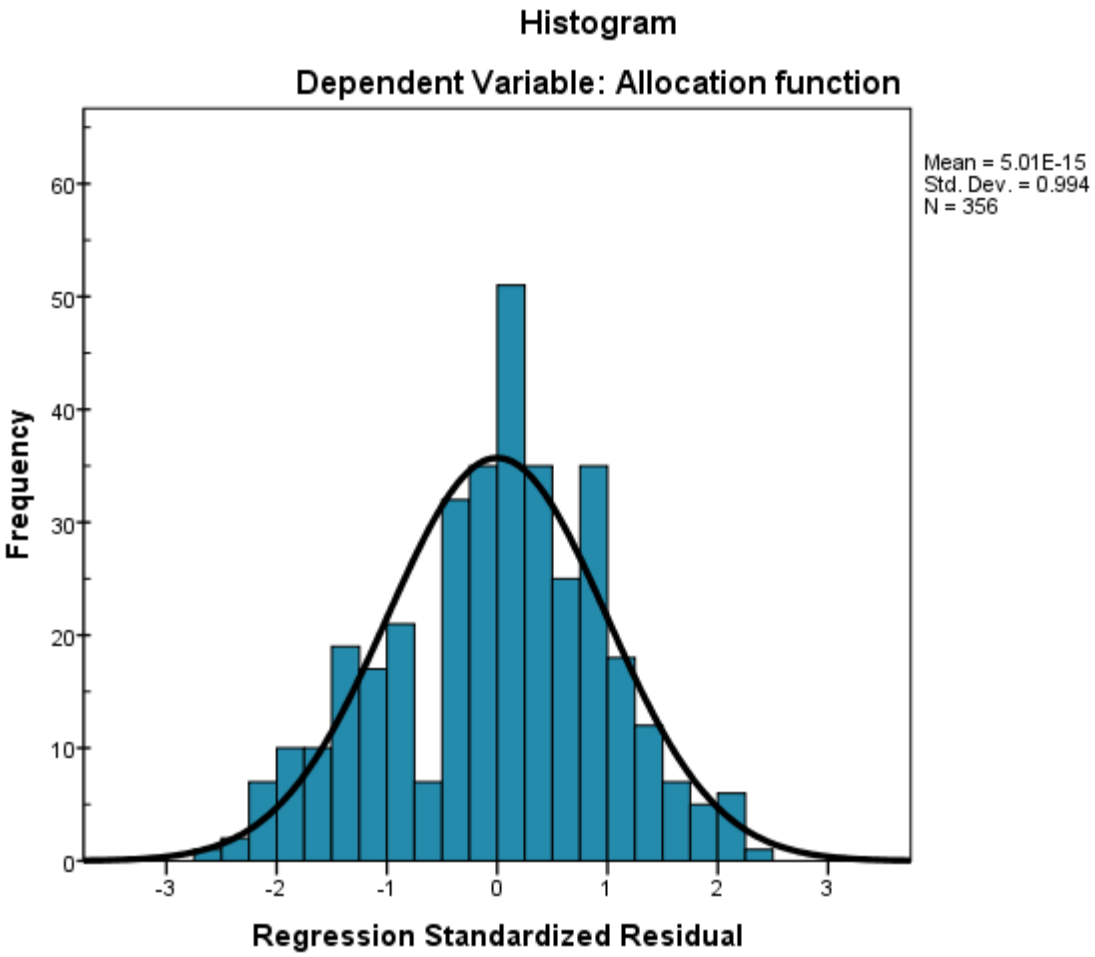
	Sig. (2-tailed)	.000	.000	.000	.000
		356		356	356
	N		356		

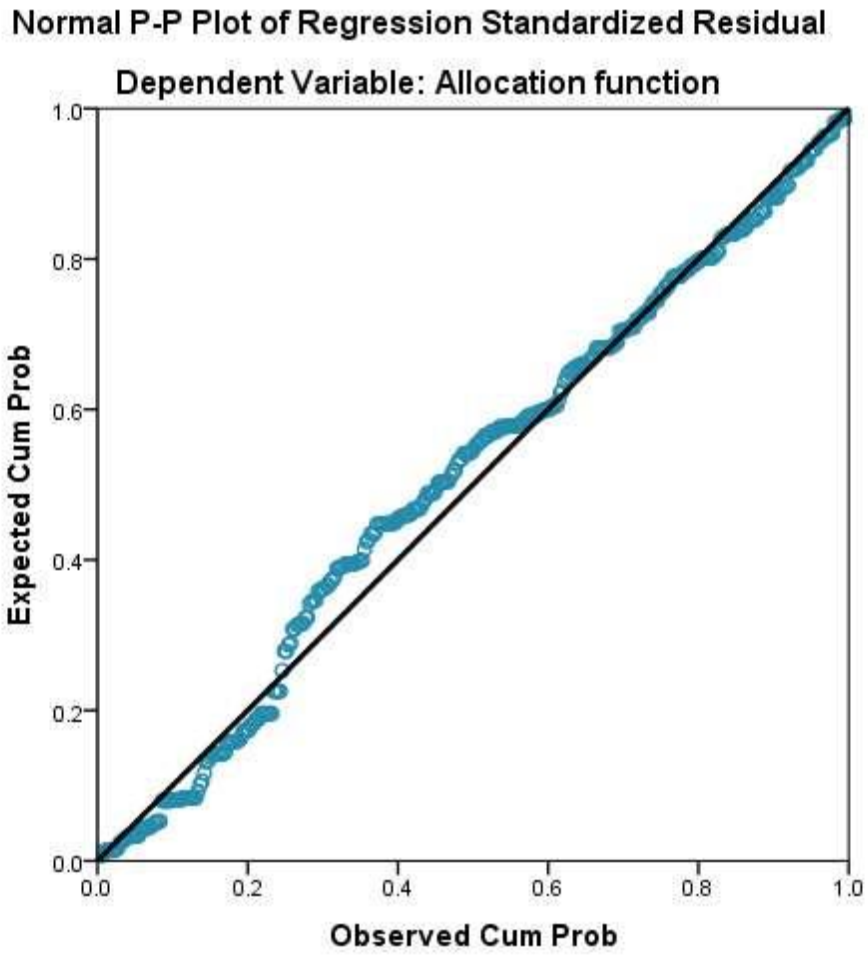
**. Correlation is significant at the 0.01 level (2-tailed).

	Model	Tolerance	VIF
	(Constant)	-	-
	Financial development	. 316	3.165
	Information disclosure	. 451	2.217
	Market liquidity	. 355	2.817
	Market volatility	. 512	1.952

Source: Own survey result, 2024


Scatterplot
Dependent Variable: Allocation function
Regression Standardized Residual
Regression Standardized Predicted Value
3
2
1
0
-1
-2
-3
-2
-1
0
1
2
3


Histogram
Dependent Variable: Allocation function
Mean = 5.01E-15
Std. Dev. = 0.994
N = 356
Frequency
60
50
40
30
20
10
0
-3
-2
-1
0
1
2
3
Regression Standardized Residual


Normal P-P Plot of Regression Standardized Residual
Dependent Variable: Allocation function
Expected Cum Prob
Observed Cum Prob
0.0
0.2
0.4
0.6
0.8
1.0