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– SUMMARY –

Cultural Determinants of Stock Market Liquidity

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INTRODUCTION

The role of capital markets in the global economy has consistently increased since 1602, when the first modern stock exchange, the Amsterdam Stock Exchange, was established. Its initial purpose was to facilitate the trading of shares of the Dutch East India Company (VOC). The company was founded by the States General of the Netherlands in 1602 to finance its expeditions to Asia, it offered the opportunity for any resident of the Dutch Republic to "participate in its success" by becoming a shareholder, which is considered today the first official initial public offer (IPO). This event marked the beginning of a new era, in which capital could be accumulated and traded in a transparent and efficient manner. With the emergence and development of other stock markets in Europe and North America, they became the primary instrument for financing wars, expanding empires, and establishing new industries.

Nowadays, at the heart of any developed economy lies the stock market, a vital instrument in efficiently allocating capital and managing risk. Stock markets, alongside the banking system, have become pillars of economic development, significantly contributing to the integration of the global economy. However, the recent financial crisis has shown us how sensitive the global economy is to stock market fluctuations and how crucial liquidity can be in such a context.

Four distinct perspectives on liquidity have emerged over recent years: a) Corporate finance perspective; b) Financial asset valuation and portfolio management perspective; c) Market microstructure perspective; d) Macro-level liquidity perspective.

Corporate finance places liquidity in a narrow company level context. It tries to explain whether the stock liquidity can influence management decisions and vice versa. The main directions on which the studies in this area are focused are:

- *the agency theory*, which refers to the impact of liquidity on the quality of governance, determined by the presence and the proportion of various types of shareholders, through the lens of the efficiency of investors' monitoring of management decisions and the possible discrepancies between the interests of management and the interests of minority shareholders (Coffee, 1991; Bhide, 1993; Maug, 1998; Admati and Pfeiderer, 2009; Kang and Kim, 2013 and others);
- *the market feedback effect* refers to the fact that a higher level of stock liquidity ensures a greater degree of incorporation of information into the price (including information about management performance), which in turn leads to the appearance of a feedback effect from the market, due to which managers of companies with strong performance are

better rewarded (Fang et al., 2009; Jayaraman and Milbourn, 2012; Kang and Liu, 2008; Fereira et al., 2011 and others);

- *the discount effect* refers to the way in which stock liquidity determines the cost of capital and the decisions regarding the capital structure of the company, which in turn are influenced by the existing information asymmetry between insiders (management and majority shareholders) and other investors (Butler and others 2005 ; Bharath et al., 2009; Lipson and Mortal, 2009; Gao and Ritter, 2010; Stulz et al., 2013);
- *market frictions* that refer to how corporate decisions (financial transparency, dividend policy, share buybacks, stock splits or share consolidation actions) influence liquidity (Miller and Modigliani, 1961; Diamond and Verrecchia, 1991; Brockman and Chung, 2001; Brav et al., 2005; Eleswarapu and Venkataraman, 2006; Brockman et al., 2008; Amihud and Mendelson, 2008; Chung et al., 2010; Lang et al., 2012);

Thus, corporate finance studies analyzing stock liquidity have identified its numerous benefits, such as increasing the quality of corporate governance, facilitating price informativeness, enhancing the effectiveness of management policies and compensation systems, reducing costs for financing the company through the stock market, and, last but not least, reducing market frictions through dividend distribution, lower transaction costs, and others.

The role liquidity plays in asset valuation is rather intuitive because a rational investor will always consider the risks and costs involved in holding an illiquid asset. There is a vast literature that shows that:

- illiquid stocks and stocks with higher transaction costs will always be valued at a price lower than their intrinsic value (Amihud and Mendelson, 1986; Brennan and Subrahmanyam, 1996; Datar et al., 1998; Chordia et al., 2001 ; and others);
- liquidity shocks are positively correlated with stock return shocks (Amihud, 2002; Jones, 2002);
- furthermore, the systematic component of liquidity and its associated risk have a significant impact on an investor's decision to acquire (or not) a particular asset (Pastor and Stambaugh, 2003; Acharya and Pedersen, 2005; Sadka, 2006; Korajczyk and Sadka, 2008; Lee, 2011).

In other words, both the liquidity level (as a characteristic of the individual security) and its variations over time (as a characteristic of the market) are important factors in determining the price of the asset and in estimating its future returns.

Market microstructure, on the other hand, gives us important insight into how stock markets structure and related trading mechanisms impact liquidity and the price discovery process. More specifically, the studies in this branch analyzed:

- the differences between the types of existing markets (Jain, 2003), and the factors that determine the investors' behavior according to market-type (Wuyts, 2007);
- the impact of algorithmic trading on the liquidity and informational efficiency of the security (Gai et al., 2013; Chung and Chuwonganant, 2014; Brogaard et al., 2014) and on how algorithmic trading contributes to the spread and amplification of liquidity shocks (Kirilenko et al., 2011);
- how liquidity is affected by market policies and regulations regarding: the minimum value of the price step (tick size) (Lau and McInish, 1995; Hsieh et al., 2008; Pan et al., 2012), the restrictions on short selling (Biais et al., 1999; Charoenrook and Daouk, 2005; Lin, 2008; Chuang and Lee, 2010; Lecce et al., 2012).

Thus, studies that focus on market microstructure contribute significantly to the in-depth understanding of the market, offering stock market administrators a clearer picture of the tools they can use to increase market liquidity.

From the macro perspective, liquidity, or more precisely commonality in liquidity, is considered one of the main mechanisms leading to the spread of financial crises. Studies such as Brunnermeier and Pedersen (2009) show that a temporary drop in prices can generate significant losses that lead to a reduction in available funding, which in turn increases the level of the systematic component and ultimately leads to a "dry up" in market liquidity.

This phenomenon is often explained through the "flight to liquidity" effect (Rosch and Kaserer, 2013), which suggests that a significant portion of market investors liquidate their positions in illiquid assets to acquire assets with higher liquidity. Studies such as Naes et al. (2011) demonstrate a strong relationship between market liquidity and economic cycles, showing that the composition of investors' portfolios varies depending on the phase of the economic cycle at that time.

Indeed, when analyzing market liquidity, we cannot overlook the impact of the real economy. At an aggregate level, market investors are exposed to the same economic environment, trading under the same economic conditions. This includes macroeconomic variables such as inflation, exchange rates, and interest rates, as well as the overall level of financial system

development and the level of investor protection and institutional quality that ensures market integrity.

Together, all these factors directly or indirectly determine the systematic component of liquidity and its evolution over time. Thus, from a macro perspective, market liquidity can be considered an indicator of the overall state of the economy, while also being a significant determinant of its performance. Therefore, the liquidity of securities is crucial for both the capital market and the entire economy. However, it remains one of the most unpredictable characteristics of the capital market to date.

The motivation for this research stems from the need to better understand the "animal spirits" that influence market liquidity and are likely to determine or amplify the next financial crisis. Culture represents a fundamental dimension of society, which is why its impact on individual behavior is inevitable, whether we are talking about the day-to-day life or individual decisions regarding the accumulation and investment of capital.

The aim of this research is to identify cultural dimensions that allow us to capture individual characteristics of investors that influence their decision to enter and trade on a stock market.

The research methodology employed in this study consists of two main components: firstly, an extensive literature review, and secondly, two empirical studies based on panel analysis. The first part of the research involved a comprehensive review of the specialized literature regarding the dimensions and determinants of liquidity. In the second part, an empirical analysis was conducted to examine how culture can affect the liquidity of stock markets.

The originality of this study lies in the analysis of the impact of investor culture on market liquidity from a new perspective, namely the social norms within their own country and the perceived distance of investors towards capital markets in other countries.

The first chapter of this study provided a concise presentation of the definition and dimensions of liquidity, along with the main measures used in empirical finance to estimate it. A brief review of the advantages and disadvantages of existing measures was then conducted, followed by a proposal to popularize a relatively new measure of liquidity that could better capture market liquidity. This section provided a solid theoretical foundation for the subsequent investigation of the determinants and impact of culture on market liquidity.

Chapter II focused on a comprehensive review of the existing literature regarding the main determinants of liquidity. These determinants were categorized into company-level, market-level, and macroeconomic factors. Moreover, we provided a brief overview of the main types of capital markets, considering their trading mechanisms and specific characteristics. Additionally, a comparative analysis was conducted to examine how liquidity is provided in quote-driven markets versus order-driven markets. This chapter laid the groundwork for further exploration of the impact of culture on market liquidity, moving beyond traditional finance theories.

Chapter III aimed to explore market liquidity from the perspective of behavioral finance, going beyond the conventional theories. We delved into the influence of cognitive biases and explore how culture can impact these biases. In this regard, we introduced the concept of cultural tightness-looseness, proposed by Gelfand et al. (2011), as a measure of social norms and their strictness. Using this measure, we analyzed the impact of social norms on the liquidity of securities, revealing that countries with moderate levels of norm strictness tend to exhibit higher market liquidity. This chapter provided valuable insights into the relationship between culture and liquidity, taking into account behavioral factors in investment decision-making.

Chapter IV focused on the impact of perceived distance on market liquidity, specifically examining the phenomenon of "foreign bias" in investment decisions. We introduced the concept of perceived distance, which was measured using psychic distance borrowed from the fields of International Management and International Business. Psychic distance refers to the factors that hinder the flow of information between two countries. By analyzing the perceived distance and its influence on liquidity, we gained a deeper understanding of how investors' subjective perceptions affect their investment decisions and the liquidity of the market. This chapter shed light on the role of perceived distance in shaping market liquidity and provided valuable insights into the interplay between cultural factors and investment behavior.

Therefore, in this doctoral thesis, our aim was to investigate the impact of investors' subjective perception on investment decisions, as captured by market liquidity.

CHAPTER I SUMMARY

Liquidity has been one of the most widely discussed and debated topics in academic literature over the past two decades, being considered by Amihud and Mendelson (1991) a "key attribute of the stock market". However, the concept of liquidity does not yet have a universally accepted definition, making it a concept that is as simple to understand as it is challenging to define.

Examining the various definitions found in academic literature in an attempt to identify a comprehensive and accurate definition of liquidity common elements are revealed. Most definitions include three key aspects: the significant volume or quantity of the asset to be traded, the price and its continuity in relation to the transaction's impact on equilibrium, and the time or duration required to complete the transaction. These elements highlight the ability to trade a substantial volume of assets, maintain price stability, and execute transactions efficiently.

Liquidity dimensions

Early works by Black (1971), Grossman and Miller (1988), and Harris (1990) highlighted four dimensions of liquidity: tightness, depth, resilience, and immediacy. Other authors such as Garbade (1982), Kyle (1985), and Holden (1990) focused on three dimensions: tightness, depth, and resilience. Meanwhile, authors like Bernstein (1987) emphasized breadth, depth, and resilience. According to Schwartz (1988), immediacy is not necessarily considered a separate dimension but rather an implicit characteristic of automated markets. More recent studies, such as those by Bervas (2006) and Sarr and Lybek (2002), have identified five dimensions of liquidity:

- *Depth:* It refers to the number of potential buyers/sellers or the number of buy/sell orders around the reference price. Depth represents the thickness or size of the order book.
- *Breadth:* It captures the volume of the asset that can be bought or sold at a specific price. In other words, it represents the actual size of orders in the order book.
- *Tightness:* It refers to the spread between the best bid and ask prices, which represents an estimate of the transaction cost. Tightness reflects the liquidity cost associated with trading.
- *Immediacy:* It represents the time it takes for an order to be executed. Immediacy is often associated with the efficiency of trading and settlement systems.
- *Resilience*: is the ability of the market to recover after the occurrence of an unexpected event.

The five dimensions of liquidity essentially encompass three characteristics of the order book: tightness (bid-ask spread), depth (number of orders near the reference price), and breadth (size or volume of orders at each price level). In addition, there are two characteristics related to the temporal evolution of events, namely, how the order book will appear after the execution of a transaction (resilience) and how long it will take to execute the order (immediacy).

The major challenge faced by studies in the field of liquidity, both nowadays as in the past, is the absence of a comprehensive measure capable of incorporating all these dimensions. Most measures capture a single dimension, with a few exceptions that manage to capture two or three dimensions. In essence, measures that capture market breadth are based on trading volume and examine the impact of volume on price changes. Measures based on trading frequency, along with volume-based measures, are often used to analyze market depth. The latter focus on the trading volume of the asset and are among the easiest to measure.

Liquidity measures

The multidimensionality of liquidity is the reason behind the lack of a universally accepted definition in empirical finance, and it is also what has hindered the construction of an adequate measure that would capture all the intricacies of a liquid market. However, over the past two decades, there has been an exponential increase in the number of studies that either propose a new estimation method or provide improvements to existing measures. More recently, studies such as Goyenko, Holden, and Trzcinka (2009), Marshall et al. (2013), and Fong et al. (2017) have initiated the so-called "horse races" among existing measures. They compare the most commonly used liquidity measures and offer recommendations on the use of a particular measure based on the research objectives and its nature.

To facilitate easier navigation through the multitude of measures proposed, some authors such as Saar and Lybek (2002), Le and Gregoriou (2020), or Diaz and Escribano (2020) have attempted to classify the measures based on the following criteria:

a) Frequency of used data:
    - high-frequency measures (using intra-day data);
    - low-frequency measure (within which daily data are used);
b) The dimension or the characteristic of the market they capture:
    - measures that capture transaction cost (tightness);
    - measures based on trading volume (breadth și depth);
    - measures that capture price impact (resilience);
    - measures that capture multiple dimensions;
c) The information required to compute the measure:
    - Volume based measures;
    - Price based measures;
    - Bid-ask spread measures;
    - Measures based on trading frequency.

The efficiency of existing liquidity measures has always been a subject for debate, the main dilemma being: what measure should be used to capture market liquidity, depending on the type of market, data availability, the phenomenon being studied, the dimensions of liquidity that are considered to have a significant impact on that phenomenon and many other criteria.

CHAPTER II SUMMARY

From a micro perspective, liquidity refers to the ease an investor, either as a seller or a buyer, can achieve their primary objective of selling or buying a certain quantity of an asset within a short time frame and at the most favorable price. From a macro perspective, liquidity is the market's ability to absorb a substantial volume of the asset without having a significant impact on the price. Thus, liquidity can be seen as the measure for which both conditions are met.

In academic literature, this measure is determined by a wide range of factors, whose importance varies across studies. It begins with the classical determinants of liquidity presented by Chordia et al. (2001): asset price, trading volume, and return volatility. However, it extends to factors such as the political party affiliation of the country's president (Marshal et al., 2018), the CEO's legal background (Pham, 2020), or shocks in the international oil market demand (Zhang and Wong, 2022).

In this chapter we focus on the factors whose importance has been highlighted and confirmed in a larger number of studies, and which refer to company characteristics, such as size, profitability, predictability, growth opportunities, quality of corporate governance and others; stock market characteristics such as the size, type, structure and mechanisms of the stock market, applicable regulations and others; country-level characteristics such as the level of financial openness, economic growth, inflation, political risk, the quality of institutions, the level of investor rights protection, the volume of foreign investment and others.

The main channels through which these factors influence liquidity are inventory risk, information asymmetry and liquidity financing.

Table 1. *Liquidity determinants*

Company-level factors		**Market-level factors**		**Macro level factors**	
ROA, ROE	Frieder and Martel, 2006; Banerjee et al. 2007; Gopalan et al. 2009; Lipson and Mortal, 2009;	*Market* Type	Jain (2003)	*Macroeconomic variables*	Goyenko and Ukhov (2009), Naes et al. (2011), Busch and Lehnert (2014)
Financial leverage	Beaupain and Joliet (2013), Norvaišienė and Stankevičienė (2014),	*Market regulations*	Bessembinder (2000), Chung and Chuwonganant (2004), Jain et al. (2005), Anand and Venkataraman (2016)	*Level of financial development*	Lee and Chou (2018), Carvajal and Bebchuk (2019)
Company size	Chordia, Shivakumar and Subrahmanyam (2004),	*Tick size*	Bourghelle and Declerck (2004), Ahn et al. (2007), Pan et al. (2012), Holden et al. (2014)	*Financial openness*	Levine and Zervos (1996), Baldwin and Forslid (2000)
Ownership structure	Chung (2007), Agarwal (2009), He et al.(2013) și Ng et al. (2016)	*Short selling constraint*	Lamont and Thaler (2003), Chanroenrook and Daouk (2005), Bai and Qin (2014)	*Institutional investors*	Aragon and Strahan (2011), Ding et al. (2017), Dang et al. (2018)
Corporate governance	Bacidore and Sofianos (2002), Brockman and Chung (2003), Chen et al. (2007), Ali et al. (2017)	*High-frequency trading*	Hasbrouck and Saar (2013), Brogaard et al. (2014), Chaboud et al. (2014), Conrad et al., (2015), Weller (2018)	*Legal framework*	Bhatttacharya and Daouk (2002), Lesmond (2005), Chung (2006)
Dividend policy	Brennan and Tamarowski (2000), Banerjee et al. (2007), Hu et al. (2019),	*Transparency*	Madhavan (2000), Boehmer et al. (2005)	*Institutional Quality and Rule of law*	Bhattacharya (2006), Eleswarapu and Venkataraman (2006).

All these factors, however, belong to the perspective of classical finance, which refers either to the profit opportunity or to the associated risk. Most of the time, however, the investment decision is affected by investor's personal perception, which until recently was not included in any empirical finance theoretical models.

Behavioral finance challenges some of the assumptions made by classical theories and seeks to shift the focus of empirical studies towards investors. Ultimately, regardless of company's profitability, economic context, or market opportunities, it is the investor who decides what, how, and when to buy or sell. These decisions are not always rational, and even when they are, they often come bundled with an under- or overestimation of the market, the company, or the information held.

CHAPTER III SUMMARY

Behavioral finance seeks to explain the irrational decisions frequently made by investors through psychological biases, such as heuristics, overconfidence, mental accounting, narrow framing, disposition effect, representativeness, conservatism, and others. These biases are often seen as cognitive errors and are borrowed from the field of psychology.

For example, the concept of heuristics refers to the human tendency to use the so-called “shortcuts” or “rules of thumb” in their decision-making process. Mental accounting, defined by Thaler (1985), refers to the "set of cognitive operations used by individuals or households to organize, evaluate, and keep track of financial activities." These concepts highlight how behavioral finance incorporates psychological insights to understand and explain the biases and cognitive processes that influence financial decision-making.

According to Bailey et al. (2009), narrow framing refers to the tendency of investors to make investment decisions on an individual basis without considering the overall perspective of their portfolio. In other words, investors may focus on the specific characteristics or individual investment performance without taking into account the broader context of their entire portfolio. This narrow focus can lead to suboptimal decision-making and a failure to effectively diversify or manage risk at the portfolio level.

The disposition effect, initially proposed by Shefrin and Statman (1985), refers to the tendency of investors to sell "winning" stocks too early (stocks that increased in value) and hold onto "losing" stocks too long (stocks that decreased in value). This behavioral bias can be attributed to the fact that investors typically dislike losses more than they enjoy gains, leading them to be more risk-averse when it comes to realizing profits and more willing to take risks to avoid recognizing losses. As a result, they may prematurely sell stocks that have generated gains to secure a profit, while holding onto declining stocks in the hope of a future recovery.

Representativeness, in the context of behavioral finance, refers to the tendency of investors to assign greater importance to recent experiences while forgetting or ignoring historical events. This cognitive bias involves disregarding or underestimating information from the past and overly focusing on recent events or patterns.

All these biases are complex psychological concepts, the determinants of which are most often investigated at the individual level. Further exploration in the fields of psychology and anthropology has revealed the existence of shared societal traits and patterns. These shared societal

traits, encompassing customs, beliefs, and values, are often attributed to the culture of a society, as described by Hofstede as the "collective programming of the mind."

Numerous attempts have been made to formalize and measure those common characteristics (dimensions) that underlie a culture. Among the most well-known are the dimensions of Hofstede, Schwartz, Globe or those found in WVS (World Value Survey). Most of these approaches have focused on individual societal values, ignoring, or underestimating the role of the social norms behind these values.

Table 2. *Cultural dimensions*

Hofstede	Schwarz	Globe	WVS
1. Individualism 2. Power distance 3. Masculinity 4. Uncertainty avoidance 5. Long term orientation 6. Indulgence	1.Autonomy vs embeddedness 2.Egalitarianism vs hierarchy 3.Harmony vs mastery	1. Performance orientation 2. Assertiveness 3. Future orientation 4. Humane orientation 5. Institutional collectivism 6. In-group collectivism 7. Gender egalitarianism 8. Power distance 9. Uncertainty avoidance	1. Traditional values 2. Secular-rational values 3. Survival values 4. Self-expression values

Social norms are the implicit guidelines governing the behavior of individuals within a society, promoting coordination, predictability, and social cohesion among its members.

The concept of cultural tightness-looseness, while related to the dimension of individualism-collectivism, captures a unique construct by measuring the intensity of social norms and the degree of acceptance for deviations from those norms within a society.

The concept of Cultural Tightness-Looseness (CTL) was first introduced in anthropology by Pertti Pelto in his work "The differences between 'tight' and 'loose' societies" (1968). Pelto describes tight societies as those with strict norms and severe punishments for their violation, while loose societies are characterized by more relaxed and permissive norms.

In general, tight societies are characterized as more orderly and strict, with a higher level of trust in institutions but also a greater distance from power. They tend to have more censorship, discrimination, and punishment for rule-breaking. On the other hand, loose societies are described as more relaxed and creative, with a greater degree of diversity, more rights, and freedoms, but

weaker institutions. They may have a higher tolerance for deviant behavior, higher crime rates, and less coordination. Extreme manifestations of tight societies can involve repression, dictatorship, discrimination, and inequality, while extreme loose societies can exhibit disorder, vices, and high levels of crime.

According to Gelfand (2006) these features, or more precisely the strictness of social norms is determined on the one hand by distant ecological and historical factors, i.e. the extent and frequency of threats that society has encountered throughout history (epidemics, natural disasters, wars and others), and on the other hand contemporary processes, i.e. the current way of life and organization of that society. Basically, the author suggests that the more threats a society had to face, the tighter it became, strict and clear rules being necessary to deal with crisis situations, any deviation from them could represent an existential threat. In the absence of such threats, a society allows itself to discard or ignore existing rules, with the emphasis being on freedom and creativity.

In 2011, starting from this theoretical model, Gelfand together with his collaborators develops the first measure of the dimension of cultural tightness loosens. In this sense, the authors built a questionnaire consisting of 6 questions, regarding the existing social norms, the society's expectations regarding a certain behavior in certain situations, the tolerance for a deviant behavior, and the extent to which the members of the society respect the social norms. Nearly 7 thousand respondents from 33 countries were asked to answer these questions using the Likert scale of agreement-disagree.

An alternative measure of the Cultural Tightness Looseness is proposed by Uz. The measure is actually an indicator of the dispersion of responses obtained in the year 2000 by the World Values Survey to certain questions regarding divorce, abortion, suicide, euthanasia and others. The author believes that the greater the dispersion of the answers, the greater the diversity in that country and respectively the looser that country is.

In the field of financial literature there are numerous studies that have analyzed the influence of culture on financial decisions. Among the most important we mention the following:

- *Grinblatt and Keloharju (2001)* conducted a study that examined the impact of cultural proximity on investor behavior in the context of Finnish companies. They found that investors were more inclined to hold, buy, and sell stocks of Finnish companies that were geographically closer to their location, communicated in their native language, and had a CEO with a cultural background similar to their own.

- *Guiso, Sapienza, and Zingales (2008)* conducted a study investigating the relationship between investor trust and participation in the stock market. They found that countries with higher levels of investor trust tend to have greater levels of participation in the capital market. The authors suggest that risk perception is influenced by both the objective characteristics of securities and investors' subjective perceptions.
- Chui et al. (2010) conducted a study examining the impact of cultural differences, as captured by the individualism, on trading volume and stock price volatility. The authors associated individualism with overconfidence and self-attribution bias, which are psychological biases that can affect investor behavior.

  Individualism refers to the extent to which individuals prioritize their personal goals and autonomy over collective interests. In more individualistic cultures, people tend to have a stronger focus on their own achievements and attributes. This can manifest in overconfidence, where individuals have an inflated belief in their own abilities and knowledge, leading them to engage in more active trading.
- *Anderson et al. (2011),* while investigating the determinants of international diversification by institutional investors across 60 countries, showed that the home bias effect is stronger in countries characterized by a higher degree of uncertainty avoidance and weaker in countries with a higher level of masculinity and long-term orientation.
- *Eun et al. (2015)* extends the analysis of the impact of culture on stock prices in the capital market by incorporating, in addition to Hofstede's cultural dimensions, the dimension of Cultural Tightness Looseness. The study shows that the co-movement effect of stock prices is stronger in countries with collectivist and tight cultures.
- *Zadeh (2022),* using the Social Capital index as a proxy for social trust in each US state, demonstrates that the level of trust impacts the informational environment of a company, increasing its credibility and its stock liquidity.

In this study, combining the findings from the aforementioned studies and the theoretical framework developed by Gelfand et al. (2011), we assume that the level of tightness-looseness influences market/stock liquidity through four channels: risk aversion, informational asymmetry, decision-making, and trust level.

Risk aversion is considered to be determined by the predominant focus type in tight vs. loose societies. Prevention focus refers to the prevention of failure (kiasu - it is more important not to lose than to win), while promotion focus refers to achieving desired outcomes. Informational

asymmetry is determined by the type of communication characteristic of each society. Narrow socialization refers to rigid and rule-bound communication, while broad socialization refers to open and informal communication. Decision-making style essentially refers to the type of thinking, where members of a tight society (due to their fear of failure) prefer to adapt an existing idea rather than come up with a new one, while members of a loose society are more creative and lazy, preferring to explore new ideas that could reduce their workload. The weaker institutions in loose societies have led to an increase in interpersonal trust, while the stronger institutions in tight societies have led to an increased trust in institutions.

Based on these four channels, we might assume a linear relationship between CTL and liquidity, where looser societies would have a higher propensity for investment in the capital market. However, as mentioned in the previous section, each of the two types of societies has its advantages and disadvantages. When taken to the extreme, neither approach is correct or efficient. A recent study conducted by Gelfand, Harrington, and Boski, analyzing 32 nations, shows that when compared to moderate societies, both tight (highly constrained) and loose (highly permissive) societies tend to be characterized by lower levels of happiness, health, and economic development. For this reason, we believe that the relationship between CTL and liquidity is curvilinear, with the highest level of liquidity corresponding to countries with a moderate level of CTL.

Thus, our working hypotheses are the following:

H_1: There is a curvilinear (inverted U-shaped) relationship between tightness-looseness and liquidity, whereby a moderate level of CTL corresponds to the highest level of liquidity.

H_2: The way in which the strictness of social norms influences stock liquidity is shaped by the level of financial education within society.

In this study, we test the two hypotheses on a sample of 45 countries (26 developed countries and 19 emerging countries) over the period 2000-2022. Following the methodology proposed by Griffin et al. (2010), securities from each country were manually filtered to exclude closed-end funds, preference shares, depository receipts, Mexican ordinary participation certificates, Peruvian investment shares, cumulative preference shares, stapled securities, rights, units, and other securities with special characteristics. Furthermore, following the approach proposed by Karolyi et al. (2012), days where more than 90% of listed securities on a particular stock market had zero returns were excluded. Additionally, in line with the caution raised by Ince

and Porter (2006) regarding data errors in Datastream, returns exceeding 200% or returns that were reversed the following day were eliminated.

In this study, we use Amihud's measure as a proxy for liquidity, considering it one of the most reliable measures for analyzing international markets. To reduce the impact of extreme values and facilitate interpretation, we followed Karolyi's suggestion of taking the logarithm and inverting the sign of the obtained values. The main data sources for this study are the Datastream platform and the World Bank website. For measuring Cultural Tightness Looseness, we use the measure proposed by Gelfand et al. (2010) as we believe it captures the societal members' perception of social norms more effectively.

Our empirical study consists of three stages: confirming the existence and significance of the relationship between CTL and liquidity, validating the obtained results through robustness tests, and analyzing the mechanisms through which policy makers can influence the relationship between the two variables.

At first, we use Pooled OLS regressions with fixed time effects and Tobit regressions and confirm the U-shaped relationship between CTL and liquidity. The coefficients remained significant at the 1% threshold, regardless of the model specification used.

Secondly, the sample of securities was divided in subsamples: based on country development level, on company size, and on industry/sector. The results for all sub-samples (except for the insurance companies at industry level) confirm a significant relationship between CTL and stock liquidity. Furthermore, the models used in the first stage were rerun using random effects regressions and random effects Tobit regressions, and the results once again confirm the robustness of the theoretical model defined by us.

In the third stage, we included in our model the measure of financial education in order to investigate the impact of financial education on the relationship between CTL and stock liquidity. There are numerous studies that have analyzed the effect of financial education on various economic decisions. There studies show that most people have a low level of financial education, which can be associated with portfolio under-diversification, low levels of investment in stock market, lack of savings for retirement, frequent changes in the allocation of accumulated capital for retirement, questionable financial decisions, and irresponsible financial behavior (excessive use of credit cards, over-indebtedness, and others).

That is why, in the last part of this study, we investigate whether the decision-making factor could influence the relationship between culture and stock liquidity, through policies aimed to increase the level of financial literacy.

The results confirm this hypothesis. Moreover, they indicate that a high level of financial literacy could reverse the relationship between CTL and stock liquidity. In other words, as the level of investors' financial literacy increase, they are more likely to overcome cognitive biases and make rational financial decisions. This finding suggests that promoting financial education can have a positive effect on market liquidity by enhancing investors' decision-making capabilities and reducing the influence of cultural factors.

The moderating effect of financial education on the relationship between CTL and liquidity has several important implications for policy makers and financial market regulators. Firstly, as the results of this study show increasing the level of financial literacy can diminish the effect of culture on stock liquidity. This means that authorities in countries with lower levels of market liquidity should implement measures aimed at increasing the level of financial literacy in order to increase liquidity.

Secondly, the results confirm our assumption that the level of development of a stock market is influenced by the extent to which the society has managed to find a balance between freedom and obedience. A "healthy" stock market cannot be developed in a conservative and over-regulated environment, because innovation is one of the main driver of development, but at the same time a lack of clear rules and adequate control mechanisms leads to chaos and the population's lack of confidence in the capital market.

CHAPTER IV SUMMARY

While the preceding chapter delved into the examination of social norms and disparities within a given society, the subsequent chapter will shift the focus towards investigating the implications of variances across different societies.

Real and perceived differences between members of a society or members of different societies have a significant impact on the decisions we make. In fact, these differences lead to biased decisions. Because, as many psychological studies show, we tend to like more people who are similar to us (speak the same language, share the same religion, have the same skin, hair, eye color, etc.). Some studies explain this bias through the fact that most of us prefer to stay in the comfort zone, to reduce the probability of conflict situations. That is, we like more people who are similar to us because we subconsciously associate differences with conflict.

The natural question that arises in this context is: "What is the connection between stock market liquidity, perceived differences and the probability of a conflict?". This is the question we aim to answer in this study.

Let's begin with the fact that academic literature associates these differences most oftenly with the concept of distance (cultural, institutional, economic, psychological, geographical, etc.), the greater the distance, the more differences there are.

International Management and International Business studies have always placed particular emphasis on the impact of distance on investment decisions. Considering during the internationalization of a company it faces a series of critical decisions such as where and how much to invest, how to organize and control foreign enterprises so as to maximize the benefits and minimize the risks and costs. In fact, according to Zaheer et al. 2012 "International management is the management of distances". Distance in this context does not only refer to geographical distance but also to cultural, economic, administrative, institutional, linguistic, religious differences and various combinations thereof. Quoting Johanson and Vahlne (1977): *"Distance represents an important barrier to information transfer, increasing the level of uncertainty and ambiguity that investors encounter when they want to enter a new market".*

Prior to 1988, the research predominantly in the field of International Affairs revolved around the influence of geographic distance. However, with the emergence of seminal works of Hofstede (1980) and Kogut and Singh (1988), there was a gradual shift towards examining the role of cultural distance. As the field progressed, criticism regarding the limitations of cultural distance, particularly highlighted by Shenkar, prompted scholars to explore alternative dimensions. Consequently, a growing body of literature emerged in the early 2000s, seeking to enhance and broaden the conceptual framework by introducing additional constructs such as institutional and psychic distances.

The concept of cultural distance primarily pertains to the cultural disparities between two countries, based on cultural dimensions (often employing Hofstede(1980)'s dimensions), which are aggregated using a composite index.

Cho and Padmanabham (2005) emphasize that since the creation of Hofstede's renowned cultural dimensions in 1980, and their inclusion by Kogut and Singh (1988) in a composite index of cultural distance, researchers have extensively employed it to explain variations in performance, strategy, and the impact of companies at an international level. They state that it has reached a

point where no study in the field of international business can be considered comprehensive without explicitly incorporating a control variable for cultural distance.

The term "psychic distance" was first introduced by Beckerman (1956) in his work on European trade flows. Although the author did not provide a clear definition of the concept, he mentioned it briefly in the closing remarks of his study. Beckerman highlights that in a similar context with equal costs involved, an Italian entrepreneur will almost always prefer to collaborate with a Swiss supplier rather than a Turkish one, considering the former to be "psychologically closer."

In the 1970s, the concept was embraced by researchers at the Uppsala University, who provided the first formal definition, specifically referring to "differences in spoken languages, culture, political systems, and levels of industrial development." Subsequently, studies such as Boyacigiller (1990) suggested expanding this list to include "religious differences, forms of government, economic development, and levels of emigration.

In International Business studies, there have been numerous studies that have demonstrated the impact of distance on various aspects:

- ***decision to export*** (Wierdesheim-Paul et al., 1978; Holzmuller and Kasper, 1990; Fletcher and Bohn, 1998);
- ***market selection*** (for export – Johanson și Valhne, 1977; Dow, 2000; for direct investment – Green and Cunningham, 1975; Davidson, 1980; Terpstra and Yu, 1988; Grosse and Trevino, 1996; Barkema, 1996; Dow, 2000; Habib and Zurawicki, 2002; Brewer, 2007; Buckley et al., 2008; Dow and Ferencikova, 2010; Palmero et al., 2013);
- ***entry mode choice*** (Chang and Rosenweig, 2001; Brouthers et al., 2001; Tihanyi et al., 2005; Shaver, 1998; Padmanabhan and Cho, 1999; Brouthers and Brouthers, 2000; Harzing, 2002; Dow and Larimo, 2009);
- ***performance in foreign market*** (O'Grady and Lane, 1996; Evans and Mavondo, 2002; Pothukuchi et al., 2002; Brouthers, 2002; Evans et al., 2008; Dikova, 2009; Griffith and Dimitrova, 2014);
- ***degree of adaptation in foreign markets*** (Mueller, 1991; Dow, 2001; Sousa and Bradley, 2005);
- ***know-how transfer*** (Dinur et al.,2009; Reus and Rotting,2009; Sarala and Vaara, 2010)

Indeed there is an International Business framework called the CAGE framework, developed by Professor Pankaj Ghemawat (2004), which aims to assist companies in the process of making internationalization decisions. The CAGE framework is based on the idea that

differences between countries can create barriers to international trade and investment. It consists of four key dimensions that capture the distance or dissimilarity between countries:

- Cultural Distance: This dimension refers to differences in language, religion, social norms, values, and beliefs between countries. Cultural differences can affect consumer behavior, communication, and the acceptance of foreign products and services.
- Administrative Distance: Administrative distance encompasses differences in governmental policies, regulations, and political systems between countries. It includes factors such as trade barriers, legal systems, bureaucratic procedures, and political stability. Administrative differences can affect market access, business operations, and the ease of doing business in foreign markets.
- Geographic Distance: Geographic distance refers to the physical separation between countries, including factors such as distance, time zones, transportation costs, and infrastructure. Geographic distance can impact transportation and logistics costs, communication, and the speed of market entry.
- Economic Distance: Economic distance represents differences in income levels, wealth distribution, market size, and economic development between countries. Economic differences can affect consumer purchasing power, market demand, and the attractiveness of a market for investment.

By analyzing these dimensions, companies can assess the level of distance or dissimilarity between their domestic market and potential foreign markets. This assessment helps in identifying opportunities and challenges in internationalization decisions.

The CAGE framework provides a structured approach for companies to evaluate potential markets, understand the risks and barriers associated with international expansion, and make informed decisions about market selection, entry strategies, and the degree of adaptation required.

In this study, our aim was to addapt the theoretical framework developed in the field of International Business and apply it to the analysis of trading activities in capital markets. Specifically, we adopted one of the most comprehensive methods available for estimating psychic distance, as proposed by Dow and Karunaratna (2006). Using this method, we calculated the psychic distance between the United States and a sample of 44 countries. Subsequently, we investigated the extent to which this distance influences the level of stock market liquidity of these countries.

According to the methodology employed, psychic distance is an aggregate measure of six stimuli: culture, language, religion, level of education, political system, and level of industrial development. Each of these stimuli represents a measure of differences as perceived by investors between the home country and the host country. In essence, psychic distance can be considered a measure of the perceived "familiarity" of American investors with the 44 countries under analysis. Previous studies in financial literature, such as Grinblatt and Keloharju (2001), Chan et al. (2005), and Beugelsdijk and Frijins (2010), among others, have shown that the perceived level of familiarity significantly influences capital allocation decisions in international markets.

Indeed, this study contributes to the existing body of financial literature by bridging the gap between the fields of finance and international business. By adopting a measure borrowed from the field of International Business, namely psychic distance, we aim to analyze the impact of country familiarity on stock market liquidity. While previous studies have extensively examined the relationship between various factors and market liquidity, the incorporation of psychic distance as a proxy for familiarity provides a novel perspective. It allows us to explore how investors' perceived familiarity with a foreign market influences the liquidity of its stock market. To achieve this objective, a series of fixed-effects regression models were conducted, which revealed that as the psychic distance from the US increases, the stock market liquidity level decreases. This relationship was confirmed through the individual analysis of each component of psychic distance. Notably, this relationship holds true for both developed and emerging capital markets. The robustness of the results was confirmed by employing alternative measures of psychic distance and cultural distance, as well as by instrumenting psychic distance with geographic distance.

Furthermore, the coefficients remained negative and statistically significant even after controlling for variables such as economic development, macroeconomic stability, capital market development, investor protection, freedom of press, and market concentration levels.

From our perspective, psychic distance has a significant impact on market liquidity through three channels: informational asymmetry, transaction costs, and trading activity. Each of these channels affects, on one hand, the presence and trading activity of foreign investors, and on the other hand, the trading intensity of local investors (both in the domestic market and in the US capital market).

Indeed, informational asymmetry naturally arises when discussing a capital market in a distant country with a different culture, language, and less widespread religion (e.g., Japan). From this perspective, psychic distance can be seen as a measure of "informational frictions," the effects of which on trading activity have been extensively studied in the financial literature. Psychic

distance captures the perceived psychological and cultural differences between countries, which can result in information barriers and increased uncertainty levels for market participants. These barriers can impede the flow of information and make it more challenging for investors to obtain accurate and timely information about the market and its participants. As a result, there may be a higher level of informational asymmetry between local and foreign investors.

Foreign investors face several challenges when investing in a market with high psychic distance. They need to allocate time and resources to effectively monitor market developments, and there is always a possibility of misinterpreting information or signals in the market. As a result, foreign investors may prefer to invest in markets that are perceived as more "proximate" or familiar. Alternatively, if they do invest in a market with high psychic distance, they may have suspicions that their counterparties possess superior information, leading to hesitation in executing trades which could significantly widen the bid-ask spread.

The costs associated with reducing the discrepancies between local and foreign investors further increase the transaction costs. Foreign investors need to invest time and money in bridging the informational gap, which adds to their trading costs. This, in turn, puts additional pressure on the profitability of foreign investors and consequently affects the volume and number of transactions they undertake.

The informational asymmetry between local and foreign investors has two main effects on trading costs. Firstly, it increases the cost of obtaining and interpreting information. Foreign investors may need to rely on translators, consultants, or local experts to gather and understand market information, which adds to their expenses. Secondly, the bid-ask spread, representing the difference between the buying and selling prices of an asset, tends to be higher in markets with higher informational asymmetry. This is due to the suspicion that one party possesses privileged information, leading to a wider spread as both parties seek to compensate for the potential information disadvantage.

The impact of psychic distance on trading activity can be analyzed from various perspectives. Firstly, it can be examined in terms of the presence of foreign investors (both institutional and retail) on the stock market. As mentioned earlier, the level of familiarity with the market plays a crucial role in attracting foreign investors. The presence of foreign investors, in turn, can have implications for the quality of corporate governance in local firms and the informational efficiency of the market.

Foreign investors bring in external expertise, knowledge, and capital, which can contribute to improving the governance practices of local firms. Their participation in the market trades can enhance transparency, accountability, and adherence to international standards. This, in turn, can enhance the confidence of domestic investors and lead to improved governance practices among local firms. Moreover, the presence of foreign investors can also enhance the informational efficiency of the market. Foreign investors often conduct thorough research and analysis before making investment decisions. They bring in new information and perspectives, which can enhance price discovery and reduce information asymmetry in the market. This, in turn, can improve market efficiency and facilitate better resource allocation.

However, the impact of psychic distance on trading activity is not solely limited to the presence of foreign investors. It also extends to the behavior of local investors. Higher psychic distance can create barriers for local investors in understanding and accessing foreign markets. This may result in a higher concentration of trading activity on domestic markets and a reluctance among local investors to engage in cross-border transactions. Consequently, the liquidity and trading volume in domestic markets may be higher compared to foreign markets with higher psychic distance.

Indeed, institutional foreign investors play a crucial role in enhancing corporate governance through the close monitoring of management decisions. Their active engagement in overseeing company operations and ensuring alignment with shareholder interests can lead to improved governance practices. By closely monitoring company activities, foreign institutional investors can identify potential agency problems, advocate for better disclosure and transparency, and encourage responsible decision-making.

Furthermore, the presence of foreign institutional investors can contribute to the informational efficiency of the market. Through their extensive research capabilities and access to global networks, they can quickly incorporate new information into stock prices. This rapid information incorporation enhances price discovery and reduces information asymmetry, benefiting all market participants.

Moreover, the trading activity of foreign institutional investors positively impacts the overall trading volume on the market. As foreign institutional investors engage in higher volumes of trades, the market liquidity increases. This increased liquidity attracts more market participants, including both domestic and foreign investors, leading to further trading activity and reduced transaction costs. Reduced transaction costs, in turn, encourage higher trading volumes as it becomes more cost-effective for investors to execute transactions.

CONCLUDING REMARKS AND FUTURE RESEARCH DIRECTIONS

Over the last two decades, we are witnessing a gradual change in the economic paradigm. This change determined by the financial crisis of 2008 and intensified by the Covid-19 pandemic affected multiple branches of economic science, but it had a particular impact on behavioral finance.

Founded in the early 80s as a response to the multiple critiques of classical theories, the field of Behavioral Finance is at the verge between finance, psychology, sociology and anthropology. The new interdisciplinary approach, brought to light by behavioral finance, allowed the analysis of investor behavior from a new perspective, that of the subjective financial decision-making process and the biases associated with it.

Some authors such as Schleifer (2000), Gromb and Vayanos (2010) or Baker (2009) focused on analyzing the impact of psychological biases on investment decisions, while others such as Grinblat and Keloharju (2001), Chan and others (2005), Chui et al. (2010) or Eun et al. (2015), went further by investigating the factors that could be driving these biases. Among the most important factors in this regard, authors highlight culture, analyzed through cultural values/dimensions.

In this paper, we set out to extend the analysis of the impact of culture on the capital market, investigating in particular its effect on stock liquidity. In this sense, in the first part of the empirical study, the impact of the strictness of social norms on the liquidity of securities in 26 developed countries and 19 emerging countries was analyzed. The strength of social norms and tolerance towards deviant behavior was estimated using the measure of cultural tightness-looseness (CTL) constructed by Gelfand et al. (2011).

The results suggest that there is a non-linear relationship (inverted U-shape) between CTL and stock liquidity, and that countries characterized by a moderate level of CTL are generally countries with more liquid capital markets.

At the same time, we have shown that one of the instruments through which policymakers could influence the relationship between the two variables is financial education. Thus, countries with a high/low level of cultural tightness-looseness (CTL) can enhance their stock market liquidity through measures aimed at increasing the level of financial literacy. Understanding financial concepts and market mechanisms helps investors to overcome cognitive biases, manifested by under-/overestimation of risks, under-/overconfidence in their abilities, nonconformity, external locus of control, and others.

In the second part of our empirical study, building upon the concept of psychic distance from International Business studies, we focused on the impact of perceived differences by investors between the home country and the host country of investments. Specifically, using the measure constructed by Dow and Karunaratna (2006), we analyzed the impact of psychic distance from the USA on the liquidity of capital markets in 45 countries.

According to our results, the greater the psychic distance from the USA, the lower the liquidity of the analyzed country's capital market. Furthermore, we highlight that psychic distance is a construct distinct from that of cultural distance, and its impact on market liquidity is more pronounced in developed countries.

By analyzing both the impact of the components/stimuli of psychic distance and the factors influencing investors' perception of this distance, we can conclude that one of the mechanisms through which policymakers (in countries with low market liquidity) could influence liquidity levels is by implementing measures aimed at reducing the discrepancies in education levels.

According to Dow (2009), investors' perception of the distance between the home country and the destination country is influenced by their level of knowledge of the local language and religion, as well as their previous travel experiences in that country.

As future research directions, it would be interesting to expand the study conducted on psychic distance by constructing a measure such as "distance to wealth." This measure could potentially provide a better understanding of a country's potential to attract foreign investors from developed countries. Additionally, considering the significant disparities among countries in our sample in terms of the number of securities and trading volume, it would be valuable to analyze the impact of psychological distance on liquidity at the individual security level while controlling for firm-specific factors such as size, profitability, or industry affiliation. This approach would allow for a more nuanced examination of the relationship between psychological distance and liquidity.

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