

What are the characteristics of an efficient market essay examples

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What are the characteristics of an efficient market?

Efficient market can be broadly defined as a continuous market without any type of arbitrage, where prices reflect all the information available in the market and relevant for evaluation. The efficient market hypothesis is based on this assumption and suggests that it is impossible to outperform the market and to gain returns in excess of market returns. Efficient market is an idealized concept that provides the framework for evaluating inefficiencies in the existing markets. In fact, no real-life market is perfectly efficient as not all information is made immediately available to all sellers and buyers, hence the price does not fully reflect all the relevant information (Block, & Hirt, 2008).

The level and kind of efficiency usually depend on the type of market. Thus, financial markets are considered the most efficient, while other markets are less transparent and efficient. Economists also distinguish between 3 forms of efficiency: weak, strong and semi-strong. If the market is characterized by the weak form of efficiency, market prices only reflect past information. Strong form of efficiency suggests that prices can reflect both public and private information instantaneously. In the semi-strong form only public information is available to all players, while insider information produces inefficiencies. This form of efficiency most fully reflects the situation in the current markets and suggests the need for financial analysis in predicting the dynamic of market prices.

Information availability is only one characteristic of the perfect market. Other factors also affect the ability of the prices to reflect the situation. Thus, fully

efficient markets should not have any transaction costs, market players are rational and all transactions occur instantaneously. In reality, however, these assumptions are unrealistic, therefore there is always an extent of inefficiency in the market, thus giving an opportunity to earn abnormal profits and to outperform the market (Aldridge, 2005).

References

- Aldridge, A. (2005). *The market. Key concepts*. Cambridge, UK: Polity Press.
- Block, S., & Hirt, G. A. (2008). *Foundations of Financial Management*. (12th ed.). Boston, MA: McGraw Hill.