

The Role of Stock Market Development in Influencing the Firms Performance: A Study Based on Pakistan Stock Market

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Received: September 23, 2018

Accepted: October 17, 2018

Online Published: November 5, 2018

doi:10.5539/ijef.v10n12p104

URL: <https://doi.org/10.5539/ijef.v10n12p104>

Abstract

The study aims to examine the role of stock market development in influencing the performance of non financial firms listed on Pakistan Stock Exchange from 2001 to 2017. Stock market development is a foremost issue of debate nowadays in emerging and developing economies. The theories and empirical studies strongly refer that stock market development is a tool to mobilize the savings and investment to promote the industrialization and firms performance. This study is an effort to establish the empirical relationship between stock market development and firm's performance. Three indicators of stock market development like stock market volatility, stock market liquidity and stock market capitalization are used for assessing the book and market performance of firms. For this purpose two-step system Generalized Method of Moments (GMM) estimator was employed in a dynamic panel model for empirical testing of hypothesis. The findings indicates that stock market volatility is a significant factor which which attempts to decrease the firm performance. On the other hand, stock market capitalization and stock market liquidity significantly causes the increase in firm firm performance.

Keywords: stock market development, stock market capitalization, stock market liquidity, Pakistan Stock Exchange, firm performance

1. Introduction

A well-developed financial system improves the efficiency of capital allocation with more productive investments (Rafael et al., 1999). Furthermore, equity markets are illiquid and highly concentrated which play a prominent role in the development of the stock market and are considered as main factors of stock market development. It seems to assume that stock market measures the ability of firms to mobilize the capital and their performance (Bokpin & Ishaq, 2008). Notably, the equity markets and firms operating in stock markets are facing the serious issues related to their performance after the financial crisis. A large part of the savings of an economy is intermediated with productive investments through financial markets and intermediaries (Levine, 1997). Since capital accumulation is a fundamental determinant for the long-term growth of any firm and an efficient financial system is essential for the development of an economy. Therefore, stock market development plays an important role for predicting the future economic growth and survival of firms (Kunt & Maksimovic, 1996; Singh, 1997; Levine & Zervos, 1998).

Developed stock markets are more liquid, less volatile, highly concentrated and is associated with high stock market capitalization. Existing models suggested that stock market development is a multifaceted concept involving issues of market size, liquidity, volatility, concentration, integration with world capital markets, and institutional development. The development of stock market is likely to be affected by stock market volatility, stock market capitalization, and trading volume. All these indicators play a decisive role for the development of stock market which in turn increases the performance of firms. This leads to the expectations that as the stock market develops, firms would prefer equity financing over debt financing in return less burden on firms' profits (Agarwal & Mohtadi, 2004).

Numerous studies has been done in relation to macroeconomic factors and firm specific factors in the way of stock market development at aggregate and firm level. In Pakistan number of studies has been done on stock market development but no empirical study has been done on the role of stock market development in influencing