Report Type

End of Award Report

Full Name

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Project Title

Does the Stock Market Benefit the Economy?

Project Start Date

Jan 01, 2015

Project End Date

Sep 15, 2018

Project Abstract

An effectively functioning stock market allocates capital efficiently and provides sufficient funds to emerging, productive firms, which in turn breeds competition and innovation, ultimately fueling economic growth. In this paper, we show that concentrated stock markets dominated by a small number of large firms are functionally inefficient. Using data from 47 countries during 1989–2013, we find that capital is allocated inefficiently in countries with concentrated stock markets, which results in sluggish IPO activity, innovation, and economic growth.

Activities and Achievement

Research works that help us understand the role of financial markets on economic growth will have a great deal of policy implications and will influence the priority that policy makers give in dealing with financial sector policies. In this regard, finance researchers have extensively investigated the role of finance in boosting economic growth. However, we still have little understanding of how stock market development promotes economic growth.

We revisit the question of whether, and if so how, stock market development promotes economic growth. We propose a new measure of stock market functionality termed “stock market concentration” We measure the extent of stock market concentration as the sum of the stock market capitalizations of the largest five or ten firms divided by the total stock market capitalization of a country’s domestic stock exchanges. The idea is that the structure of stock market, not just its size, can better capture the functional efficiency of stock market. In a concentrated stock market dominated by a few large firms, an entrepreneur with a good investment project may have more difficulty in obtaining required capital than in a stock market that is not. A more concentrated stock market then leads to less funding available to potential users of stock market financing.

We show that concentrated stock markets dominated by a small number of large firms negatively affect economic growth; in countries with concentrated stock markets, capital is allocated inefficiently, which results in sluggish IPO activity, innovation, and economic growth. These findings suggest that a concentrated stock market offers insufficient funds for emerging, innovative firms; discourages entrepreneurship; and is ultimately detrimental to economic growth.

Dissemination

I am revising the paper with my co-authors to resubmit the paper to the Journal of Financial Economics, a top finance journal.

Outputs

Major Difficulties and Any Other Issues

none

Web Links

none

Additional Information

Declaration

This award has not yet produced any relevant outputs, but details of any future publications will be submitted to the CERF database as soon as they become available.