Effects of Financial Development and Institutions on Firm Growth in Malaysia

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ABSTRACT

This study is motivated by Modigliani and Miller's (1958) financing constraints theory (FCT) and others like Rajan and Zingales (1998), Fisman and Love (2007), and Manganelli and Popov (2013) also sharing similar enthusiasm that firm growth are dependence on access to external finance but subject to macroeconomic environment. Using firm-level data from firms listed in Bursa Malaysia for 2006-2014 period, the study applies dynamic panel system generalized method of moments (GMM) estimation (Blundell and Bond, 1998) to estimate how a country's embedded financial development and institutional quality impacts the linkage of firms' external financial dependence and growth opportunities to firm growth. A dynamic system GMM approach is employed to address the endogeneity and serial correlation concern. Firms which have greater growth opportunities actually grow faster with better financial development with embedded good institutions in the case of Malaysia. So findings concluded that firms experience higher growth through better allocation of finance since they have good potential to grow. This has shed important lights to policymakers in formulating the design of many financial development policies across a wide set of countries aimed at fostering financial markets and banking services sector to provide the vital sources of external financing needed by corporations in financing their investments. A well-functioning financial system is a necessary condition for promoting firm growth.

Keywords: Firm growth; financial development; institutions; external financial dependence; growth opportunities