Abstract

The Real Effect of the Primary and Secondary Equity Markets on Economic Growth and Firm Performance

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This thesis presents four empirical essays in financial economics examining the impacts of equity markets on economic growth and firm growth. The first essay examines the role played by primary and secondary equity markets in economic growth. It departs from standard literature to integrate both markets and to explicitly acknowledge the primary equity market. By employing a variety of dynamic panel estimators for 54 countries over the period 1995-2010, the results show that the primary equity market is not an important determinant of economic growth, although it facilitates the development of the secondary market. This study also confirms the importance of liquidity provided by the secondary market. The evidence here calls for further investigation into the capital-raising function of equity.

The role of equity markets on the growth at the macro-economic level and at the micro-economic level is intersected at the relationship between stock prices, foreign portfolio equity flows, and exchange rates. This linkage has important implications for the international portfolio management and the impact of stock markets on firm performance. The second essay examines the portfolio theory prediction that there is a negative correlation between stock prices and exchange rates. It draws on transmission channel of foreign portfolio equity investments and tests this by extending the Dumitrescu and Hurlin (2012)'s bivariate stationary Granger non-causality test in heterogeneous panels to a trivariate setting in the framework of Toda and Yamamoto (1995). Using macro panel data for eight emerging and developed economies implementing managed or free float exchange rate arrangement, the result shows that Indonesia may be the only case where stock prices affect exchange rates through portfolio equity flows.

The third essay exploits prospectus information to examine the nexus between the motivation and post-issue performance in initial public offering (IPO) firms in Indonesia, an emerging economy with an underdeveloped but rapidly growing equity market. Previous studies have examined the role of intended use of IPO proceeds in the context of seasonal equity offering or IPO pricing. This essay extends the literature to consider the intended use of IPO proceeds as a limited form of motivation in the context of post-issue operating performance. It distinguishes between capital and strategic motives, accounts for compositional data with zeros, and employs quantile regressions to examine a panel of Indonesian firms over the period of 2000-2010. The results suggest that IPO motivation can explain post-issue firm performance. Investment in fixed assets and in stock market shares seem to lead to better performance for average and high performing firms while other usages lead to poor performance. Further, investment in fixed assets associates with better performance in post-issue era, compared to existing studies showing that such investment is just not responsible for the decline in operating performance. These findings are robust when ownership structure is controlled. In this case, there is evidence of a non-linear relationship between the retention rate of initial entrepreneurs and operating performance or employment. A limitation of this study is the potential endogeneity of IPO motivation that requires further investigation.

The last essay experiments with a similar framework to the first essay in terms of firm level. It is also a natural extension of the third essay by incorporating the effect of the secondary market. Instead of using liquidity measure as the proxy for secondary market, this essay examines investment-to-price sensitivity – the degree how stock prices affect real investment decisions – and the stock price informativeness. Investment is therefore the central theme: the cash proceeds are raised by selling new shares to the public represent investments in the primary market, while market-driven investments are for the secondary market. This study provides an integrated framework to study the real effect of both markets on firm performance. It is expected that a higher investment-to-price sensitivity and stock price informativeness together with IPO motivation and cash proceeds lead to better post-issue operating performance.