

## SHARE TRADING & ECONOMIC GROWTH IN SRI LANKA

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### Abstract

Most of the capital market researchers in various countries revealed that there is a linkage exists between share trading operations and the economic growth. This study, tests the impact between share trading operations and economic growth in Sri Lankan context employing multiple regression models using twenty years data from 1995 to 2014. The main purpose of this research is to identify the relationship between share trading operations and Sri Lankan economic growth. The study measures the share trading in terms of the Growth of all share price index (ASPI Growth), Market Capitalization Growth (MC Growth) and Market Turnover Growth as independent variables where as the economic growth measures in terms of Gross Domestic Product (GDP) as depending variable. Further two control variables (Inflation Rate (IR) and Exchange Rate (ER)) were used to arrive at a reasonable finding regarding the association between share trading operations and the economic growth.. The empirical findings of the study confirmed that there is a positive relationship between share trading operations and economic growth in Sri Lankan context with 57%. This result confirms that 57% of the variation of the GDP will be explained through selected independent variable and control variables over the above particular period.

**Keywords:** Share Price Index, Economic Growth, Gross Domestic Product, Market Turnover, Share Trading Operations

### Introduction and research problem/issue

In equity market scenario, share market is the place where investors can trade shares to make profits or to raise equity and debt capital in order to invest in feasible investments and this place is also known as where the shareholders' wealth is maximized. Share market is also recognized for mobilizing domestic resources and facilitating for long

term financing on investment with future prospects. Colombo Stock Exchange in 1985 who operated the share trading around the country has experienced a major development after 1978 as the government was set up liberalizing economic policies. Also, The establishment of the Securities & Exchange Commission of Sri Lanka (SEC) in 1987 have contributed more to the development of capital market to the economy by protecting the interests of investors, promoting professional standards and developing and regulating equity market in orderly fair and transparent manner. Later the introduction of Central Depository system (CDS) to facilitate script less trading appeared to have encouraged share market activities in CSE. In this context, firms require long term capital to invest in new investments to maximize shareholders' wealth. For instance, companies may need to expand the existing business and/or new ventures and to purchase new equipments so that companies need long term capital where internal funds are not adequate to reinforce for those. A well functioned share market facilitates companies to raise long term funds. Hence share market assists companies to collect necessary funds for new investments and also contributes towards to the country's economic growth by way of increasing national production through speed capital accumulation and better resource allocation. This is a must in a sophisticated market oriented economies in order to respect the investors while contributing their finance to the share trading, so that the researchers are to explore their courage in research on this paramount theme.

Some researchers have said that there is a positive relationship between share trading and economic growth. However some researchers argued that there is no relationship between share trading and economic growth. In the light of the outcome, it has been become difficult to come into a conclusion on the contribution of share market investment to the economic growth. Also, share trading operations are important in the growing countries since it reflects growth of the firm's operations. Having an understanding about these economic reflections will add value to the parties who are interested in. As finance under graduate, studying about the economy and share trading operations will bring the practical familiarity to the real world.

Gaining a profit by stock market investing is a not an easy practice. It may be carried as a sideline business by an investor but the amount of knowledge needed to invest cannot be insignificant. An intuitive person may succeed once but that does not work for all time. Most of the succession times come through the experience in this field. Success in this field is a combination of the experience, knowledge and luck as well. So studying the link between these economic factors is very important and because of that, this study will be a proper guidance to the potential investment decisions and be success.

Therefore, this research aims to evaluate the relationship between share trading and the economic growth based in Sri Lanka.

### **Role of Share Market**

The share market is often considered as primary indicator of country's economic growth. "The share market provides support for share market activities and it often cited as a measurement of business. An active share market relied upon to measure changes in the general economic activities using the share market index".(Obadan, 1995).

Researchers theoretically argued that share market contributes for economic growth and indicate for resource mobilization. There are several ways which share market foster to economic growth.

Firstly, show that large share market can decrease the cost of mobilizing savings, thus facilitating investment in most productive manner. On the other hand well develop share market increase savings by enhancing the set of financial instrument available to servers to diversify their portfolio and efficiently allocate capital to the productive investments which eventually leads to an increase in the rate of economic growth. In doing so, it provide an important source of capital at relatively low cost. And also Share market plays an essential role in growing industries that ultimately affect the economy through transferring available funds from savings to borrowings. This process leads to enhancement of available financial resources which affects the economic growth. (Majali & Assaf2014)

Secondly, , stated that share market development leads to enhance the efficiency of intermediation such as reducing information cost, transaction cost and monitoring costs. Efficient share market mobilizes savings, promote investments by identifying good business opportunities, monitoring the performance of the top management, diversification of the risk by trading or hedging and facilitating exchange of goods and services. The ultimate result of these activities will achieve the long term development of the economy of the country. Better decisions of top management represent the capital market discipline that indirectly related to the economic development.

Thirdly, share market also affects economy through the creation of liquidity. According (Bencivenga Bruce and Rose 1996 )to without liquid share market there would be no industrial revaluation, because savers not willing to invest in large, long term projects. Other thing is liquidity closely related to the function of risk diversification. So share market can influence to economic growth when they are internationally integrated. This enables greater economic risk sharing. Because higher return projects also tend to be competitively risky, share market that facilitate risk diversification encourages a shift to higher return projects . Final result would be boosted the economy leading to growth through the shifting of society's savings to higher return investments. Also, savings and investment increase due to reduction of riskiness of investment facilitated by share market liquidity.

### **Research Methodology**

Share trading operations were measured by using market capitalization, market turnover and market return. Economic growth was measured by using GDP growth rate. Size of the share market was measured by using market capitalization. Market turnover measured using turnover ratio and total value traded ratio. All share price index used to measure market return. This research is based on annual data during 1995 – 2014 periods. Data was collected from Central Bank of Sri Lanka annual reports, Central Bank of Sri Lanka publications and Colombo Stock Exchange publications etc. The analysis of data was done with regression analysis and exploratory data analysis methods. Data consists of All Share Price Index, Market Capitalization, Market Turnover of CSE, Gross Domestic Product, Inflation Rate and the Exchange Rate. This

data is used to calculate the growth rates of all the above indicators other than Inflation Rate. The reports for data collections for the CSE were derived from CSE website and their printed materials for the period of 1995 - 2014; a set of 120 observations is retrieved. Furthermore, the annual GDP growth rate, inflation rate and exchange rate in Sri Lanka was obtained from the annual reports of the Central Bank of Sri Lanka in order to see the relationship between share market performance and economic growth in Sri Lanka. The multiple regression analysis was used to analyse the data into meaningful manner so that the result was interpreted according to the following formula.

$$EG = \alpha + \beta_1 (MC) + \beta_2 (MT) + \beta_3 (MR) + \beta_4 (IR) + \beta_5 (ER)$$

### Results and findings

This section predicts the results of the study by analyzing the data obtained from the sample, to measure the relationship between share trading and the economic growth in Sri Lanka. In this study, the relationship analyzed using a multiple regression model. According to the multiple regression model tested by using the data that the researchers are collected, the following table predicts the results.

**Table 01**  
**Regression Results**

Model	F	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin - Watson
1	0.756	0.571	0.418	1.299	1.39

- a. Predictors; ASPI Growth, MC Growth, TO Growth, ER, IR
- b. Dependent variable; Economic Growth

This model achieved the R<sup>2</sup> value of 57.1% indicating that the variations of GDP will be explained through the selected independent variables and control variables. In addition, adjusted R square was used to identify the explanatory power and there is tendency of explanation by 41.8% of independent variables and control variables on the dependent variable. Tendency of explanation of GDP is 41.8% when more variables add to the above multiple regression model with the aforesaid variables. Further remaining 42.9% variations of the GDP will be explained by other variables. According to the

Durbin Watson test also carried out to check the auto correlation among the independent variables, which indicates no auto correlation. In this study represent the independency of data set by achieving Durbin Watson value as 1.39.

According to the Multi-Co-linearity Analysis the results are as follows.

**Table 02**  
**Tolerance and VIF Values**

Model	Tolerance	VIF
ASPI Growth	0.033	30.66
MC Growth	0.03	33.056
TO Growth	0.517	1.936
IR	0.845	1.184
ER Growth	0.82	1.219

The above table shows the auto correlation between the variables. It means the independency among the variables. Since the tolerance value reached lesser than 1, represent the independency among the variables. The results of VIF indicate that VIF for the dependent GDP Growth is less than 10 for independent variables except ASPI growth and MC growth indicating that the presence of non harmful co linearity among TO Growth, IR and ER Growth

**Table 03:**  
**ANOVA table**

Model		Sum of squares	df	Mean Square	F.	Sig.
	Regression	31.495	5	6.299	3.732	0.23
	Residual	23.631	14	1.688		
	Total	55.126	19			

According to the ANOVA table mention above, it represent the ( $F_{20, 5\%} = 0.23$ ) lesser value than 0.05 threshold with the control variables. It prescribes the successfulness of overall model.

### **Conclusions, Implications and Significance**

Share trading operations is vital for sustaining a healthy business economy in any country. The optimal effect of equity capital investment of quoted business enterprises affect to the economic growth that predicts adjusting point between share trading operations and the country's economic growth. The basis of this study is to explore the effectiveness of share market investments and gross domestic productivity in association with the Sri Lankan economic growth. A correlation analysis revealed that a negative significant relationship is found between the gross domestic product growth rate and the exchange rate growth. Other than this relationship, the independent variables; market capitalization growth rate and market turnover growth have positively correlated whereas all share price index growth and inflation rate growth have negatively correlated. It is important to note that only one control variable exchange rate growth is negative significant association with economic growth. In aggregate, share market operations have both positive and negative associations with economic growth in Sri Lanka. Also, in the events of inflation and exchange rate movements in the country, it is negatively associated with Sri Lanka's economic growth. This is reasonably efficient functioning of share market investment and its management found in terms of market capitalization and turnover has somewhat impact on economic growth. The variables collectively ASPI growth, MC growth, market turnover growth in association with control variables inflation rate growth and exchange growth rate have significant impact to the country's economic growth including gross domestic production at the rate range of 57.1%. Remaining impact of 42.9% is associated with the other factors. As a result of the above, the professionals should apprehend one effective share trading and investments operations management. Finally, The results of this study suggest that the managers and other stakeholders pertaining to share market investments should attend on efficient utmost care to increase profitability of all domestic production of the whole economy in an optimal manner in order to increase the country's economic growth.

Future research should investigate generalization of the findings beyond the different sectors of Sri Lankan share market (especially in the banking finance & insurance etc) in a comparative or individual manner. The scope of further research may be extended to the share market operations. In this study, the researchers found that there is a

relationship between the share market operations and economic growth according to the variables substituted. Hence, the researchers applied the control variables as inflation growth rate and exchange rate growth to find further strong relationship; it is proved in some cases. Even though, no strong evidences have been found to prove the significant effect between share market operations and economic growth, so that, the researchers would elaborate for further research to find out a strong impact on this in the different business sectors in Sri Lankan stock market or this space will be extended to anyone for future research.

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