

Financial Liberalization and Small Firms-Growth Nexus: A Case of Pakistan

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Abstract: The current study attempts to determine the impact of financial liberalization on the growth of non-financial small-sized Pakistani firms. For empirical analysis, this study uses cross-firm panel data set of firms listed on Karachi Stock Exchange (KSE). The results indicate that total assets and economic development of the country significantly associated with the growth of small firms. On the other hand these firms' growth does not affected by financial development. The equity finance negatively associated with firms' growth.

Jel Classification: G0 • D53 • D63 • O1

Key words: Financial liberalization • KSE • Equity • Economic development

INTRODUCTION

In order to remove inefficiencies of financial institutions, bringing stability to enhance the economic growth, the Pakistan implemented the financial reforms in 1990s successfully [1-3]. Businesses are significantly related to the successful financial system. For any business there are two main sources for raising capital; internal and external. The major internal sources include retained earnings, whereas the major external sources include loans from financial institutions like banks and equity finance.

The most prominent external determinant of the firm's growth is the financial system. Firms prefer to use the external sources for their financial needs; especially small firms which have limited sources of raising capital [7-8]. The well-developed financial institutions provide loan to firms as well as play an advisory desk role. The financial development and growth studies conclude that finance has concern for growth, both at macro and microeconomic level [9-5].

For a growing economy a well working and proper financial system is important to support the economic activities and to establish a competitive market.

An efficient financial system helps to provide the basis for implementation the effective policies and mobility of capital to the more productive uses [11]. The well-developed financial markets make easier for firms to exert financing for their investment needs and the rate in which resources are allocated to productive sectors depends on the development of the financial system [12].

The industries more dependent on external finance grow faster in economies which have a more developed financial system [13]. Especially the small firms in an underdeveloped system face higher obstacles because of lender uncertainty about them. The small firms more adversely affected by lower access to external finance. The banking sector improvement creates a positive effect on the process innovation of these firms and firms which are more dependent on external finance [14-16].

In the case of Pakistan the trend of using internal finance is significantly higher; the firms use more than 50% finance from their internal sources [17]¹. Due to costly bank finance, firms turn to other sources of finance like to retained earnings and equity capital.

The key objective of the current study is to explore the impact of financial liberalization on the growth of non-financial small-sized Pakistani firms.

¹ World Business Environment Survey, include 10,000 firms from 80 developed and developing economies.

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Table 1: Structure of Banking Sector in 1990

	Number of		Shares (%)		
	Banks	Branches	Assets	Advances	Investment
State-owned	7	7043	92.2	92.1	93.5
Private	0	0	-	-	-
Foreign	17	45	7.8	7.9	6.5
Total	24	7088	100	100	100

Source: Financial Sector Assessment 1990-2000, SBP

Overview of Financial Sector Reforms in Pakistan:

In order to make financial sector more efficient, competitive and transparent the financial sector reforms were initiated in the late 1980s in Pakistan. All banks of the country including State Bank of Pakistan (SBP) were nationalized in 1974. The main objective of nationalization was to provide capital to top priority projects and to make sure the depositor capital protection [18]. Although nationalization took place for the socio-economic benefits, however the required results could not be obtained. With the state owns the banking sector did not work efficiently, which leads the lower saving and investment, hence lower economic growth [19].

Even though private investors were allowed for opening non-banking financial institutions, however, the share of the private sector was much lower in this market; the state-owned financial institutions hold more than 93 percent of total assets of the financial sector at the end of 1980s. Beside other problems, the lower range of financial products and unavailability of consumer and mortgage financing was also important. These deficiencies created many macroeconomic difficulties up to 1990s and impede overall economic growth. Consequently, to remove these distortions and enhance efficiency of financial markets to boost up economic growth, a sturdy and effective supervisory system was essential. So, at the end of 1980s the government of Pakistan initiated financial reforms.

The financial reforms implemented in Pakistan can be classified into three phases.

First Phase: The first phase of financial reforms covers the period 1988 to 1996. The major steps of this phase include the downsizing of extra staff, closing of overextended branches, privatization of state-owned banks, recovery of non-performing loans (NPLs), the introduction of international accounting standards and the initiative of banking court.

The steps like nationalization destroyed the role of the private sector as well as diminished the performance of banks. In 1990, seven domestic and seventeen foreign banks were performing their operations in Pakistan. The domestic banks owned more than 92 percent assets of the banking sector (as shown in Table: 1). The Major concern of foreign banks was to deal with international trade.

In order to enhance competition and the efficiency of banks, the entry of private investors in the banking market was encouraged. Consequently, in 1991, the 26 percent shares of each of the two banks; Muslim Commercial Bank (MCB) and Allied Bank Limited (ABL) were sold to private investors. Later, in 1993, the 26 percent shares of United Bank Limited (UBL) were also sold. Gradually to encourage the private investment in opening new banks, the Nationalization Act 1974 was revised in 1991 and as first step twenty-three banks were allowed to operate. In order to facilitate existing investor's business, in 1995 a ban imposed on opening new banks and easy conditions applied to existing investors to spread the branch network more. In 1994 the computerization process began, later intra-net facility along with the in-house application software was started. To make ensure greater security and efficiency in payment systems, the SBP launched its website and got membership of the Society for Worldwide Inter-bank Financial Telecommunication (SWIFT).

In the first phase finally, full authority was granted to SBP and it became an autonomous body.

Second Phase: The second phase of financial reforms spans from 1997 to 2001. Due to political intervention, inefficient judicial system and lack of good governance in late 1996, about one-third of banking assets were trapped in the form of NPLs and defaults and most cases of default loans remained unresolved. Major victims of default and NPLs were Nationalized Commercial Banks (NCBs) and Development Finance Institutions (DFIs)². Other causes of losses include excess staff and the overextended branch network [20-22]. Due to these reasons the need for further reforms was felt. Thus with the support of the IMF, World Bank and Bank of Japan in the start of 1997, new reforms were initiated.

In this phase the partially privatized banks were completely sold out. Private investors were facilitated to spread their branch network and promote business, thus

² NCBs and DFIs had over 90% of their loans as default.

Table 2: Post-Privatization Structure of Banking Sector

Banks	Number	Assets		Deposits		Equity	
		Amount*	Percentage*	Amount	Percentage	Amount	Percentage
State-owned	4	518.8	18.6	379.3	20.1	22.5	17.2
Private	20	1840.3	66	1292.3	68.5	92.8	70.9
Foreign	13	278.4	10	198	10.5	26.7	20.4
Specialized Banks**	3	149.8	5.4	16.1	0.9	-11.1	-8.5
Total	40	2787.2	100	1885.6	100	130.9	100

* Rs. Million and share in percentage

**Specialized Banks include ZaraiTaraqiati Bank Limited (ZTBL), Industrial Development Bank of Pakistan (IDBP) and Punjab Provincial Co-operative Bank

Source: State Bank of Pakistan

enhance their market share. In 1997, SBP adopted two new systems³ to monitor and assess the performance of banks. Furthermore, in 1997 the government of Pakistan modified two laws i.e. Banking Companies Ordinance (1962) and State Bank of Pakistan Act (1956). The Pakistan Banking Council was closed down and responsibility of regulating the banks was assigned to SBP.

In this phase the Banking Tribunal Ordinance (1984) and Banking Companies Ordinance (1997) were also cancelled through the proclamation of Banking Companies Ordinance (1997). To increase the role of SBP as a regulator, the government divides it into three parts; I- SBP as the central bank I- SBP-Banking Services Corporation (SBP-BSC) III- National Institute of Banking and Finance (NIBAF).

Third Phase: The third phase of reforms covers the period from 2002 to 2004. Several improvements were seen in this phase. The major changes include; increase in the minimum capital requirement, a number of mergers and acquisitions were taking place, the average capital base of a commercial bank has risen from 1.8 billion in 2000 to 3.7 billion in 2003, permission granted to banks for establishing separate subsidiaries to work as mutual funds, venture capital, foreign exchange companies and the asset management companies, etc. Several consumer products like auto loans, credit cards and the housing finance was introduced to facilitate lower and middle income sectors. Later Small and Medium Enterprises (SMEs) financing was also included in this lending products group, E-banking was improved. An early warning system known as IRAF⁴ was also developed.

In order to decrease the level of NPLs, the government and SBP established the committee for revival of sick industrial units (CRSIU) and corporate and industrial restructuring corporation (CIRC). The committee recovered Rs. 46 billion from 172 industrial units in this regard. Due to rising NPLs and the failure of CIRC, in 2002, national accountability bureau (NAB), CRSIU and the SBP issued guidelines whereby banks are actively encouraged to settle NPLs with borrowers at the fore sale value (FSV) of the original collateral. Under the strategy of 10 percent down payment, Rs. 52 billion of NPLs has been settled at the cost of around Rs. 35 billion.

During the decade of 1990s, the average annual growth rate of total assets for commercial banks was 14.4 percent [23]. This compound growth rate can be divided into two parts; up to 1997, it was 17.8 percent and the after 1997 period, it was 7 percent. It was due to increased returns on NSS⁵ instruments, golden handshake scheme, branch closure program, freezing of foreign currency accounts (FCAs) and the nuclear explosion. Interestingly, the performance of private and foreign banks was much better in the overall banking industry, especially up to 1997, before the freezing of FCAs. The share of private sector's assets in the banking institutions jumped from 7.8 percent in 1990 to 46 percent in 2000 of total banking industry.

After the third phase a tremendous improvement can be seen in the banking industry of Pakistan (as shown in Table 2) the share of private sector in the total assets of banking industry reached to 66 percent which was zero in 1990, whereas the state-owned banks' share declined to 18.6 percent in 2004 from more than 92 percent in 1990.

³ CAMELS (Capital adequacy, Asset quality, Management quality, Earnings, Liquidity and Sensitivity to Market Risk Systems and controls) and CAELS (Capital adequacy, Asset quality, Earnings, Liquidity and Sensitivity)

⁴ Institutional Risk Assessment Framework

⁵ National Saving Schemes

Capital Market Reforms: In financial reforms, the focus was not only in the banking industry; however the capital market was also targeted. Several changes were made in its structure to move the flow of investment funds to more productive uses. So, to improve the market infrastructure several steps like to strengthen the governance, effective regulation and the supervision were taken. To increase the market strength, the government publicly offered shares of several state-owned companies like Pakistan Telecommunication Corporation (PTC), MCB, ABL and the Hub Power Company (HUBCO) for sale.

Under the Exchange and Payment reforms foreigners and overseas Pakistani citizens can trade without any prior permission in the stock exchange market⁶. As a result, Pakistan economy received a heavy inflow of foreign investment. Moreover, to improve the confidence of foreigners in Pakistani markets they allowed to retain the 100 percent shares of any company and allowed to take out any foreign currency amount freely, which they brought [23]. The CLA took an important step to remove the restrictions on the price setting of new share issues. In order to broaden public participation and to promote the contribution the Capital Issues Act, 1947 (Continuance of Control) was repealed and Companies Rules, 1996 initiated.

Moreover, a very important step like establishment of Central Depository Company of Pakistan Limited (CDC) was taken in 1993, but it started its operations in 1997. Due to the establishment of CDC the electronic transfer of shares became possible. The establishment of Pakistan Credit Rating Agency Limited (PACRA) and DCR-VIS⁷ was also important efforts to boost up the market transparency. In addition, the automation of all three stock exchange markets of Pakistan and their modified rules and regulations enhanced the investors' confidence and growth of the business activities.

Literature Review: The local banking sector development is a key determinant of firms' growth, regardless of their size [26-27]. A close relationship between firms and banks can reduce the agency cost and increase the firms' access to bank loans; as a result firms' performance boosts up [28]. A strong association exists between the structure of financial systems, the characteristics of industries and growth & investment of these industries [30].

In concentrated banking markets, new firms face greater difficulty in getting credit; the more powerful banks create hurdles for new entrants to protect the sale and profitability of their existing clients. The banks provide loans to aged and mature firms on priority basis. The bank competition leads to lower rate of interest which plays a supporting role for entry of new firms in the industry [31-32]. The bank competition and better institutions create a positive impact on the firms' growth and their entry in the industry. The local financial development affects differently on large and small firms. The large firms have greater access to finance in an integrated financial system whereas smaller firms are still relying on the local system [33-35].

The unavailability of the funds from financial institutions or at higher interest rate influence the firms' investment pattern and decisions. The quantity and kind of investment are different in economies with poor financial markets as compared to developed. In less developed economies firms prefer to invest in safer and short term projects [36].

The foreign banks also play a crucial role in the development of business. The immature firms benefit more in the presence of foreign banks, whereas the firms associated with domestic or state-owned banks experienced worse. The foreign banks provide loans on the purely economic basis not on the relationship or political basis. However the small and younger firms do not fully benefited from foreign banks' entry in the local market. In developing nations, there are small banking markets, higher government interference and larger share of state-owned banks; as a result firms face more problems to obtain bank finance [37-39].

The local banks reduce the firms' growth whereas equity finance increases the growth. On the other hand informal sources of finance diminish the growth [40]. The banks are unable to evaluate the latest improvement in technology, so admonish the businesses to invest in innovative projects. The firms that rely more on other sources of finance than banks, get more developed and have a larger number of patents and thus have more ways to finance further patents. The firms using arm length financing involving more innovative and creative activities [41-42]. The stock market development has a significant and negative relationship with firms' debt levels relative to their equity place.

⁶ Except a few industries, this required advance approval

⁷ PACRA was a joint venture of IFC (International Finance Corporation), IBCA (International Bank Credit Analysis) limited England and the Lahore Stock Exchange, whereas DCR-VIS is an establishment by Duff & Phelps Credit Rating Company and the Vital Information Services.

The financial development effects differently on small and large firms. It affects more on small firms; the countries with developed financial system have a greater portion of small firms in total business. The smaller firms have lower access to information than large firms; the financial development minimizes these barriers and improves the access of small firms to various types of information. On the other hand, small firms have fewer tangible assets and hence collateral, so financial improvements allow them more access to capital without strict collateral requirements [43].

The financial, legal and corruption matters are most adversely affected to small firms. These firms also face higher obstacles because of lender uncertainty about them [44-45]. The banking sector improvement creates a positive effect on the process innovation of small firms and firms which are more dependent on external finance[46-47].

MATERIALS AND METHODOS

In the light of theory and previous studies in the current study the following model has used

$$FG_{it} = \beta_0 + \beta_1 Equity_{it} + \beta_2 TA_{it} + \beta_3 FD_{it} + \beta_4 EFD_{it} + \beta_5 FD_{it} * EFD_{it} + \beta_6 BB_{it} + \beta_7 EDC_{it} + \mu_{it} \quad (1)$$

where

- FG - Firm's Growth
- Equity - Share Holder's Equity
- TA - Total Assets
- FD - Financial Development
- EFD - External Financial Dependence
- BB - Number of Bank Branches
- EDC - Economic Development of the Country

Financial Development is measured by following two indicators

FD1-Private Credit/GDP

FD2-Average Market Capitalization/GDP

The subscripts *i* and *t* denote individual firm and time period respectively.

In order to avoid the prospective multicollinearity the both indicators of financial development used in two alternative regressions equation. The description and sources of the variables can be seen in Table 3.

Methodology

Fixed Effects Approach: The financial liberalization affects differently on each firm growth. Through the use of firm-specific intercepts or “fixed effects model” (FEM) or “Least Square Dummy Variable” (LSDV) in a panel data model it is possible to control for the firm-specific, time invariant characteristics. In FEM, the individual-specific effect is a random variable that is allowed to be correlated with the explanatory variables. The FE estimator is numerically identical to pooled OLS including a set of $N - 1$ dummy variables which identify the individuals and hence, an additional $(N - 1) \times 1$ vector of parameters γ . The estimator $\hat{\phi}_{LSDV} = [\hat{\beta}_{LSDV} \hat{\gamma}_{LSDV}]$ is generally not consistent as the number of parameters goes to infinity as $N \rightarrow \infty$. From the numerical identity with the FE estimator the $\hat{\beta}_{LSDV}$ being consistent while $\hat{\gamma}_{LSDV}$ is inconsistent. The equation 1 can write in FEM or LSDV as

$$FG_{it} = \psi_1 D_1 + \psi_2 D_2 + \dots + \psi_N D_N + \beta_1 Equity_{it} + \beta_2 TA_{it} + \beta_3 FD_{it} + \beta_4 EFD_{it} + \beta_5 FD_{it} * EFD_{it} + \beta_6 BB_{it} + \beta_7 EDC_{it} + \mu_{it} \quad (2)$$

where D_1 to D_N are dummy variables to estimate the individual intercept for each cross section (firm).

Table 3: Description and Sources of Variables

Variables	Description	Sources
FG	Natural logarithm of firm's annual real sales	BSA
Equity	Natural logarithm of ordinary share capital	BSA
TA	Natural logarithm of total assets	BSA
FD1	Ratio of private loan to GDP	SBP
FD2	Ratio of market capitalization to GDP	WDI
EFD	An index based on Rajan and Zingales (1998)	Author's Own Calculations
BB	Natural logarithm of number of bank branches operating in the country	SBP
EDC	Natural logarithm of average GDP per capita	WDI

BSA- Balance sheet analysis of joint stock companies listed on Karachi stock exchange published by State Bank of Pakistan (SBP).

WDI- World Development Indicators

Random Effects Approach: Unlike FEM, in the random effects model (REM) or “Generalized Least Square” (GLS) approach, the individual-specific effect is a random variable that is uncorrelated with the explanatory variables [37]. In the case of FEM there are too many parameters, so the loss of degrees of freedom can be avoided if the ε_i can be assumed random. In this case $\varepsilon_i \sim IID(0, \sigma_\varepsilon^2)$, $\mu_{it} \sim IID(\sigma_\delta^2)$ and the ε_i are independent of the μ_{it} . Moreover, the X_{it} are independent of the ε_i and μ_{it} for all i and t . The REM is an appropriate specification if we draw ‘N’ individuals randomly from a large population.

The base line equation (eq. 1) can be mold into the below equation for RE approach

$$FG_{it} = \beta_0 + \beta_1 Equity_{it} + \beta_2 TA_{it} + \beta_3 FD_{it} + \beta_4 EFD_{it} + \beta_5 FD_{it} * EFD_{it} + \beta_6 BB_{it} + \beta_7 EDC_{it} + w_{it} \quad (3)$$

where w_{it} is a random error term with a mean value of zero and equal to

$$\varepsilon_i + \mu_{it}$$

ε_i is an individual-specific effect and μ_{it} is an idiosyncratic error term.

Hausman Test: The Hausman specification test (1978) is the standard test to check whether the FE or RE approach is better for a concerned data. The test can be executed by comparing $\hat{\beta}_{RE}$ and $\hat{\beta}_{FE}$ for a subset of coefficients of time-varying variables. The Hausman test is based on the following Wald statistic

$$H = (\hat{\beta}_{FE} - \hat{\beta}_{RE}) [\hat{W} \hat{\beta}_{FE} - \hat{W} \hat{\beta}_{RE}]^{-1} (\hat{\beta}_{FE} - \hat{\beta}_{RE}) : \chi_p^2$$

Where p is the number of time-varying regressors. Under null hypothesis $\hat{\beta}_{RE}$ is consistent and efficient and $\hat{\beta}_{FE}$ is consistent but inefficient; whereas under the alternative hypothesis the $\hat{\beta}_{RE}$ is inconsistent but $\hat{\beta}_{FE}$ remains consistent. If there is no statistically difference between the covariance matrices of the two approaches (RE and FE), then the correlations of the RE with the regressors are statistically insignificant. The Hausman test is a type of Wald χ^2 -test with $k-1$ degrees of freedom

(where k = number of parameters) on the difference matrix between the variance-covariance of the FE with that of the RE [38].

Data: Annual data of non-financial Pakistani firms listed on Karachi Stock Exchange (KSE) spanning time period from 1984 to 2010 is used for econometrical analysis. The firm level data is obtained from balance sheet analysis of joint stock companies listed on Karachi Stock Exchange published by State Bank of Pakistan (SBP), whereas the data of macroeconomic variables is obtained from World Development Indicators (WDI) and various issues of annual reports published by SBP.

A main deficiency in obtaining data of listed firms in Pakistan is that the data is inadequately available and not reliable for some firms. So, firms which have data less than 5 years were skipped from the panel. Furthermore, remaining firms’ data also ranges from 5 to 25 years, thus an unbalanced panel of eight firms is available for the analysis purpose⁸.

RESULTS

In order to find the impact of financial liberalization on firms’ growth, this study used Ordinary Least Square (OLS) then on the basis of Hausman test FE or RE Approach and for robustness check, the Generalized Method of Movement (GMM) is used.

Correlation Results: Table 4 presented the correlation matrices.

Among dependent variables the FD1 and FD2 shows the higher correlation (> 0.50). This can be caused of multicollinearity in the analysis. However, the use of these variables in two alternative equations prevents any serious affect like multicollinearity on the analysis.

Hausman Test Results: In order to check whether FEM or REM is suitable for our concerned data the Hausman test is employed. The Hausman test (1978) is based on the Wald χ^2 -test which compares the $\hat{\beta}_{RE}$ and $\hat{\beta}_{FE}$ for the subset of coefficients of time-varying variables and differentiates which one is better for a concern data.

⁸ To classify the data into sizes the study used measurement settled by SME Bank; the small firm consists of total assets up to Rs. 20 million.

Table 4: Correlation Matrixes of Variables

	FG	Equity	TA	EFD	FD1	FD2	BB	EDC
FG	1.000							
Equity	0.161	1.000						
TA	0.701	0.437	1.000					
EFD	0.087	0.038	0.110	1.000				
FD1	0.057	0.154	0.023	0.168	1.000			
FD2	0.055	0.371	0.069	0.145	0.576	1.000		
BB	0.299	0.268	0.335	0.091	0.177	0.197	1.000	
EDC	-0.051	0.340	0.042	0.051	0.360	0.457	0.322	1.000

Table 5: Results based on Hausman Test

Equation	χ^2 - Stat	Prob.	H ₀	Suitable Approach
1 (With FD1)	55.031	0	Reject	FEM
2 (With FD2)	54.133	0	Reject	FEM

H₀: the RE is consistent and efficient and FE is consistent but inefficient

Table: 6 Results Based on OLS and FE Approach

Variables	OLS		FE	
	1 (With FD1)	2 (With FD2)	1 (With FD1)	2 (With FD2)
Equity	-0.255** (-2.101)		-0.524* (-3.884)	
TA	1.290* (-8.617)		1.280* (-5.102)	
FD1	3.30 (-0.792)		-0.415 (-0.122)	
EFD	0.045 (-0.398)		0.057 (-0.640)	
FD1*EFD	-0.225 (-0.404)		-0.294 (-0.618)	
FD2		0.012 (-1.413)		-0.009 (-1.219)
FD2*EFD		0 (-0.344)		0 (-0.057)
BB	2.788 (-1.152)		0.941 (-0.439)	
EDC	0.600** (-2.136)		0.354*** (-1.588)	
Constant	-8.843 (-0.990)		-4.807 (-0.604)	
	R ²	R ²	R ²	R ²
	0.549	0.555	0.741	0.744
	F-Stat	F-Stat	F-Stat	F-Stat
	14.017	13.238	15.501	15.352
	DW-Stat	DW-Stat	DW-Stat	DW-Stat
	0.840	0.831	1.410	1.421

In parenthesis t-statistics values are given, *** and ** are statistically significant at 1, 5 and 10% respectively

Table 5 reports the results based on Hausman test. The null hypothesis of the test; Random Effect is consistent and efficient is rejected. So, Fixed Effect approach is used.

OLS and FE Approach Results: Table 6 presents the results of estimating equation (1 and 2), each equation estimated twice; with FD1 and then by replacing with FD2.

The results indicate that total assets and economic development of the country have a positive and significant association with small firm growth. Total assets include cash, machinery, building, inventory and even patents & copyrights. In spite of being collateral these asset items play, a vital role in firms' operations and profitability themselves and hence growth. The both indicators of financial development do not significantly associated with firms' growth. Results also show that external financial dependency and the increasing number of bank branches does not show a significant pattern. On the other hand equity finance is negatively associated with firms' growth.

CONCLUSION

The current study estimates the impact of financial liberalization on growth of non-financial Pakistani small firms. For empirical analysis, the study utilized cross-firm panel data set of eight firms listed on (KSE), spanning the period 1984 to 2010. For the purpose of econometric investigation, this study uses OLS and to find the individual specific effect of the model, the FEM is used. Due to higher correlation between FD1 and FD2, the study used two alternative econometric equations, inserted one indicator of financial development at a time. The results indicate that total assets and economic development of the country are crucial factors which impact the firm's growth, whereas both indicators of financial development does not significantly associated with the firm's growth. Although the financial liberalization process seems pleasant, however it works better in the presence of developmentally institutions, a strong legal system, protected property rights and finally the governing body

in its proper structure. In an underdeveloped financial and legal system firms are forced to turn to alternative sources of finance other than banks.

Policy Recommendations: In the light of above discussion we can recommend some policies like.

The interest rate should be minimized to encourage the small investors and entrepreneurs to take loans from banks and invest more in the country. Moreover the collateral requirement and transaction cost for these firms should also be minimized. Due to corruption in the banking market, a number of investors rely on informal or other sources of finance. The corruption can be erected by making the bank official's role clear and limited. The concerned authorities should invite foreigners in the banking sector so that banking concentration could be eliminated. The presence of foreign banks can dampen the banking concentration and obstacles in obtaining bank finance faced by firms, so it needs to encourage them. As compared to developed economies the institutions are much weaker in Pakistan, law & order situation should improve and investors as well as their investment should be saved whether civilian or military government ruled in the country. In order to encourage the small business the loan should be provided them conveniently.

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