

## Investigation of Stock Market Development and Financial Leverage of Corporate Firms: An Emerging Market Experience

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This study assesses the relevancy of stock market development to the financial structure of firms in Sri Lanka, paying emphasis to the hypotheses derived from various theories.

The investigation uses cross-sectional tests. They include regression and correlation based empirical models to examine the effect of stock market development on the financing pattern of the firms.

The investigation led to the main conclusions that: (a) the Sri Lankan firms' financing decisions rely initially on external financing and on new equity issues to finance their growth net equity taking advantage of the low cost of capital in conjunction with the increases in the stock price (the adjustment is faster where the firms suffer from internally generated free-cash); (b) when the emerging stock markets develop in the country, the financial leverage ratios will generally fall reflecting both the higher proportion of equity, and the debt and equity as complementary sources.

In order to promote further stock market development and to provide a variant of efficient finance options to the firms, markets must observe various basic securities markets functions, and those should be implemented through laws and regulations as well as through a number of commonly accepted practices viewed from a trade development perspective not merely as disciplinary function.

Key Words: Financial Leverage; Market Capitalization; Emerging Stock Markets; Stock market Development; Economic Development

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