

Study on the Role of Financial Market's Development in Capital Ratio of Banks Listed on the Tehran Stock Exchange

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Abstract

Market development is one of the goals of accelerated and continuous economic growth which plays a major role and has always been one of the key topics in economic development, thus, market development is considered as one of the preconditions for growth and economic development. The objective of this article is evaluation of the effect of financial market and bank's development on capital ratio of banks listed on the Tehran Stock Exchange during the period from 2009 to 2014 which includes 11 banks and 66 observations. Spss and Eviews were used to test the hypotheses. The results indicated that there is a direct and significant relation between the development of capital market and capital ratio of bank and direct and significant relation between the development of bank and capital ratio of bank.

Keywords: Development of capital markets, Development of bank, Capital ratio, Economic development.

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Introduction

Financial markets have a major role in channeling funds towards sectors of the economy and industry and consequently economic improvement. Financial markets are

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focused on due to the major role in collecting resources through small and large savings in the national economy, optimizing the flow of financial resources and leading those toward spending and investment needs in productive sectors of the economy. The positive effects of the securities market on economic development including incentives to increase investment by reducing the risk, pricing risk and facilitating liquidity risk and mobilization of deposits and ... are so great and sensitive in a way that some economists believe that the difference between developed and underdeveloped economies is not in developed technology and is rather in active and widespread integrated financial markets (Samadi et al., 2007). However, the most important question facing researchers and investors has always been the fact that is there a relation between development of the capital market and banks' capital ratio? Is there a relation between development of banks and capital ratio of banks? On this basis and according to the raised questions and the effect which development of on this basis, and considering can have on capital ratio, the present research is trying to evaluate the role of this capability in banks listed on the Tehran Stock Exchange in order to determine the extent to which the development of financial markets can affect banks' capital ratio.

Theoretical Foundations

Nowadays, most developing countries seek to access facilities, methods, techniques and tools to achieve higher and sustainable economic growth, development of financial markets can be named among these methods because greater development of financial markets allows wider participation of low-income groups of society in economic activity and allows a wider range of population be involved in the increased production of the society. But lack of development of financial markets, especially in developing countries has made the use of these tools to be associated with a significant risk because due to existence of incomplete and inefficient financial markets in developing countries, many people do not have financial access on one hand and mobilization of resources and savings is not done quite appropriately on the other hand. Because of this inefficient financial structure, the investment process is delayed, job opportunities limited and cost of funds financial resources are greatly increased. Also, due to inability of financial system to allocate savings to productive and efficient investments, these savings are converted into non-productive investments (land, gold, etc.).

Financial development refers to a situation in which the provision of financial services by financial institutions is increased and all members of society benefit from a wide selection of services. Economic growth also implies on an increase in production or national income per head and makes the intended economy have the ability to experience higher growth rates and be in the line of economic development in a faster rate. If the production of goods or services increases in a country by any means possible, it can be said that economic growth has happened in that country. Financial development is one of the policies which is recommended by many economists in order to achieve economic development. It can be said that financial development of each country has a key role in the development of its economy. Developed financial markets such as financial markets of developed countries control a considerable amount of relevant economic and financial capital. These markets are responsible for creating incentives to have saving and convert savings to investment with the aim of capital formation and therefore have a key role in

accelerating economic growth. Financial markets are formed of three sections including money, insurance and capital market. Insurance has been separated from capital markets due to its volume and importance even though it is in itself a part of the "Capital Market". Nowadays, the financial sector of countries are divided into two groups of money and capital markets. Capital market refers to financial trading market with a maturity of more than one year and assets without defined maturity. Capital Market is a part of the financial market and has an important role in saving money and providing investment needs of production units. Capital market is much broader than money market and has a greater variety of tools (Sameti et al., 2012). The objective is to develop financial markets which are one of the most important parts of modern societies to help economic and political stability, make public have confidence in these markets, long-term stability of the financial system to be maintained and ultimately, the constituent parts of the financial system be relied upon and trusted.

A review of the literature

Foreign researches

Witte Svaneti (2014) carried out a study about evaluation of effect of development of financial markets on risk of banks in capital market of Thailand. This research was done for the period of 1990 until 2012. The research results after fixing the effects of economic and company variables showed that there is a positive relation between market development and capital ratio and this relation is negative in case of beta, the results also showed that when market development does not have an effect on capital ratio, it has a positive relation with beta but if development is effective on capital ratio, its relation with beta would be negative.

Khalid and colleagues (2012) evaluated the effect of corporate governance mechanisms and disclosure of those on financial market's development. In this research, the disclosure of corporate governance is based on a checklist in which 7 sectors of corporate governance disclosure are evaluated. The results show that promotion of corporate governance and increased focus on ownership, board independence, increased audit quality as well as increased institutional ownership lead to promotion of financial markets' development.

Dong and Soo (2010) evaluated the effect of working capital management on profitability of companies listed on Vietnam's stock exchange in the period between 2006 and 2008. The relation between cash conversion cycle and liquidity and corporate profitability was evaluated in this article. The results show that there is a significant negative relation between cash conversion cycle and profitability. There is also a significant negative relation liquidity and profitability of these companies.

Joshua (2007) used panel regression model with a sample of small and medium-sized businesses in Ghana and South Africa and showed that the overall level of debt and long-term debt are inversely related to organizational performance which was measured with Tobin's Q, this result indicates the fact that organizations may use a higher debt ratio

instead of the proper level to reduce the conflicts of interest between managers and shareholders and as a result, high debt ratio will lead to lower performance.

Prasad and Heller (1997) carried out a research entitled “testing role of information technology in the productivity and profitability of the US retail banking industry” and tried to explain the role of new technologies in increasing the profitability of the mentioned banks. The results of their study showed that Investment in IT systems does not affect the productivity of banks but the costs of workforce in information systems positively affect the productivity of banks.

Domestic researches

SeyyedNourani, Amir and Mohammadian (2012) evaluated the causality relation between bank capital and profitability with an emphasis on regulatory aspect of capital structure. In this article, two indicators including Return on assets (ROA) and return on capital (ROE) have been used as an indicator of profitability and two variable including volume of bank capital and debt to capital ratio was used as indicators of bank’s capital. The results indicate that there is a positive relation between financial leverages and return on capital as well as between return on assets and net assets. In addition, the relation between debt ratio and profitability indicators have also been estimated.

Sabaie (2011) carried out a study entitled “evaluation of the relation between macroeconomic variables and the profitability of Parsian bank” in which he evaluated macroeconomic variable (Price index, gross domestic product, unemployment rate and the index of Tehran Stock Exchange) and profitability of Parsian bank in 2004 to 2008 and frequent seasonal data and concluded that there is a reverse relation between profitability of Parsian bank and the index of Tehran Stock Exchange and gross domestic product and a direct relation with unemployment rate with this assumption that prices index is constant.

Mahdavi and Mahdavi (2011) carried out a study to evaluate the effectiveness of direct foreign investment and financial market development on economic growth of Iran. They believe that the reason for lack of positive effectiveness is domestic situation in the host country to attract foreign direct investment benefits. One of the conditions for the positive effectiveness is direct foreign investment on economic growth in developed financial market. Results of their study indicate that Iran's financial market development is not enough to have significant effect on direct foreign investment on gross domestic product. In addition, financial market index has negative effect on gross domestic product.

Research Method

The statistical population, sampling method and sample size

Banks listed on Tehran Stock Exchange with accounting data from their financial statements during the years 2009 to 2014.

Research method according to objective, data types and method of implementation

This research is considered as a developmental research in terms of objective because the results obtained from it can be used in decisions of managers, investors and analysts. It is also considered as a descriptive – correlation research in terms of method of deduction of hypotheses because regression and correlation techniques will be used to explore the relations between variables which makes this research an analogy argumentation research. Also, since we will reach our conclusion by testing existing data, this research is in range of proving theories.

Data collection method

Data required for the research are collected from libraries, statements issued by the Securities and Exchange comprehensive bank of information about banks listed on the official website of the stock exchange the application processor manage and etc. Initially, literature and theories related to the subject of research are collected through library resources, publications, articles and scientific articles (academic sites). Then the main stage research starts by extracting information from financial statements of banks listed on the Tehran Stock Exchange. The extracted information is summarized and categorized using Excel and finally the mathematical relation between dependent and independent variables is determined through the software eviews and spss using regression method.

Data collection tools

Library and field methods are used to collect data which are explained below. The theoretical foundation of research has been collected from books and Persian and Latin magazines and articles extracted from the Internet. The field section of research has been carried out by studying documents by referring to Tehran Stock Exchange or databases of these organizations and collection of data through evaluation of financial statements of private banks which are required to be collected to calculate the variables of research. Finally, the raised hypotheses are accepted or rejected through the analysis of collected data.

Questions and hypotheses of research

Given the fact that development of market can affect the capital ratio of banks active in the Tehran Stock Exchange and in line with evaluation of this effectiveness, following questioned are raised and were are trying to find answers of them:

- 1) Is there a relation between development of capital market and banks' capital ratio?
- 2) Is there a relation between development of banks and banks' capital ratio?

And the following hypotheses are proposed in order to answer the posed questions on the basis of determined relation:

- 1) There is a relation between development of capital market and banks' capital ratio.

2) There is a relation between development of banks and banks' capital ratio.

Model and variables of research

Regression model to test the hypotheses:

Model used to test the hypotheses is as follows:

$$CTA_{it} = \beta_1 + \beta_2 SMD_{it} + \beta_3 BSD_{it} + \beta_4 FDI_{it} + \beta_5 SIZE_{it} + \beta_6 LIQ_{it} + \beta_7 NLOAN_{it} + \beta_8 TRADE_{it} + \beta_9 ROA_{it} + \beta_{10} ROE_{it} + \beta_{11} CIR_{it} + \varepsilon \quad (1)$$

In which, CTA (capital ratio) is the ratio of total capital to total assets

Independent variables are: SMD (development of market) which is the ratio of capital market's value to gross domestic product and BSD (development of banks) which is the ratio of bank deposits to gross domestic product.

Controlling variables of the research are: TRADE (degree of openness of economy) which is the ratio of sum of exports and imports to gross domestic product, FDI (degree of openness of market) which is the ratio of foreign investment to gross domestic product, SIZE (size of company) which is the natural logarithm of the total assets of banks, LIQ (cash) which is the ratio of cash to total deposits, NLOAN (net debt) which is the ratio of net loans to total deposits, ROA (return on assets) which is ratio of gross profit to total assets, ROE (Return on Equity) which is the ratio of net profit to equity and CIR (cost in revenue) which is the ratio of operating expenses to total revenue.

Research findings

Research findings will be presented in form of two parts: (1) descriptive statistics and (2) inferential statistics as follows.

Descriptive statistics of research variables

In general, methods by which we can process and summarize the collected data are called descriptive statistics. This type of statistics simply describes the society or sample and its purpose is calculation of parameters of society or sample (Azar and Momeni, 2010). In this study, the data of 11 private banks (Eghtesade Novin, Parsian, Parasad, Tejarat, Sarmayeh, Sina, Saman, Saderat, Ghavamin, Karafarin and Mellat) were evaluated over 2009 to 2014 and the criteria to select banks were being private and having financial statements in the selected period. In descriptive statistics, data analysis has been carried out using enteral indices such as mean, median and dispersion indices such as standard deviation, skewness and kurtosis. Summary of descriptive statistics related to research variables have been presented in table 1 after v and removing the outliers².

². Outliers are observations that are located farther away from other data and have values larger or smaller compared to other e values in the data set. Outliers can have adverse effects on statistical analysis such as increasing the variance of the error reducing the power of the test, disrupting normal distribution of data and bias estimation of parameters and the researcher is required to remove those after identification

Table 1: descriptive indicators of the studied variables

Research variables	Mean	Median	SD	Minimum	Maximum	Skewness	Kurtosis
Capital ratio CTA	0.045291	0.037433	0.025602	0.008830	0.122890	0.961723	1.256437
Development of banks BSD	621147.97	63228.82	1.214207	4766.692	4598581.16	2.188304	3.233586
Development of the market. SMD	5837961.5	65845.59	1.121141	7826.17	460689.41	1.869782	2.312533
Degree of openness of economy TRADE	235.5519	39.70262	327.9937	16.51261	746.5517	0.946839	1.899244
Degree of openness of market FDI	9.936336	0.697999	14.91708	0.357376	33.18227	0.948495	1.899922
Size of company SIZE	8.457746	8.532002	0.376173	7.554744	9.159759	-0.29102	0.378623
Cash LIQ	0.010926	0.010376	0.006485	0.001855	0.032299	0.812609	1.349559
Net debt NLOAN	1.008052	0.812317	1.081464	0.616505	7.148686	1.19883	2.701144
Return on assets ROA	1.750337	1.370805	1.224264	0.040822	4.434493	0.770383	2.581535
Return on Equity ROE	20.17244	20.27252	8.593479	1.123011	40.71176	-0.204611	2.984588
Cost in revenue CIR	0.301683	0.313935	0.156806	0.071116	0.630174	-0.052954	1.933579

Mean is considered as the most original and most important central index which shows point of balance and center of distribution. As it can be observed in table 1, the mean capital ratio is 0.045291. Median is the point which divides a sample into two equal parts. In other words, 50% of observations are before it and 50% of the observations are after it. As it has been shown in table 1, the median of variable of capital ratio is 0.037433.

In general, scattering indexes are indexes which evaluate and compare the scattering of observations around the mean. Standard deviation is one of the most important scattering indexes. According to above table, this index is 0.025602 for capital ratio. It should be noted that the maximum amount of capital ratio is 0.122890 and its minimum amount is 0.008830. Skewness of capital ratio is equal to 0.961723 and its kurtosis is equal to 1.256437.

Inferential statistics

Inferential statistics used in this study includes Pearson correlation and multivariate regression in order to explore the relation between independent and dependent variables by controlling the effect of other variables. In addition, regression default tests have been used to be sure about the reliability of results. It should be noted that the results of correlation tests between research variables will be presented before the report of results of multivariate regression.

Correlation test

Initially, the Pearson correlation test will be carried out for the research variables. The results of Pearson correlation test are shown in table 2.

As it can be seen in table 2, Independent and control variables do not have a strong correlation (correlation coefficient is lower than 0.8) and thus, there is no problem in estimating models.

Table 2: Pearson correlation

Variable	Development of the market	Development of banks	Capital ratio	Return on assets	Return on capital	Degree of openness of market	Degree of openness of economy	Cash	Size of company	Cost in revenue	Net debt
Development of the market	1	0.020** 0.000	0.014 0.035	0.067 0.038	-0.259 0.034	0.363** 0.000	0.463** 0.000	- 0.010 0.034	0.479** 0.004	0.248 0.024	-0.090 0.016
Development of banks		1	0.036 0.036	-0.321 0.020	- 0.0308 0.022	0.769 0.000	0.769** 0.000	- 0.034 0.048	0.547 0.001	0.345 0.042	-0.102 0.049
Capital ratio			1	0.726** 0.000	0.245 0.055	-0.116 0.008	-0.119 0.046	- 0.291 0.090	-0.367 0.030	- 0.423* 0.011	-0.087 0.019

Return on assets				1	0.687 0.000	-0.295 0.085	-0.300 0.080	- 0.237 0.012	- 0.450** 0.007	- 0.645** 0.000	0.028 0.872
Return on capital					1	-0.395 0.019	-0.396 0.019	0.044 0.023	-0.365 0.031	- 0.554** 0.001	0.157 0.067
Degree of openness of market						1	0.715** 0.000	- 0.254 0.042	0.264 0.026	0.166 0.041	-0.101 0.565
Degree of openness of economy							1	- 0.252 0.145	0.264 0.125	0.171 0.326	-0.105 0.549
Cash								1	0.255 0.139	0.182 0.295	0.606 0.000
Size of company									1	0.483 0.003	0.015 0.032
Cost in revenue										1	- 0.313** 0.067
Net debt											1

** = Significant at 99% confidence level; * = significant at 95% confidence level

Testing the normality of dependent variable

One of the most important regression assumptions is normality of remains of model. Normality of the dependent variables leads to normality of remains of model (difference between the estimated values and real values). Thus, it is necessary to control the normality of dependent variable before estimation of parameters. For this purpose, normality of data is evaluated using Jarque and Bera test so that the collected data are testable.

Results of this test have been shown in table 3. According to this test, remains resulting from estimation of research model have normal distribution at the confidence level of 95%.

Table 3: Jarque and Bera test

Variable	Jarque and Bera statistic	Significance level
Capital ratio	1.460131	0.605351

Evaluation of reliability of variables

The reliability of variables must be evaluated before analyzing research data. The reliability of variables means that mean and variance of variables has been fixed over time and covariance of variables has been fixed between different years. Thus, using these variables in the model does not create spurious regression. Levin, Lin and Chu, Im Pesaran, Shin and Dickey-Fuller tests can be used for this purpose. The Im Pesaran, Shin test is used for this analysis.

Table 4: Im Pesaran, Shin test

Variable	T-statistic	Significance level
Development of the market	-7.2488	0.0000
Development of banks	-5.6367	0.0001
Capital ratio	-3.5415	0.0127
Degree of openness of economy	-4.3406	0.0019
Degree of openness of market	-4.3883	0.0017
Size of company	-4.2320	0.0022
Cash	-4.3964	0.0014
Net debt	-5.7745	0.0000
Return on assets	-3.7789	0.0070
Return on Equity	-4.7686	0.0005
Cost in revenue	-3.4401	0.0165

According to table 4, the significance level of research variables is less than 5%, thus, all variables are stable in the period under review. Then, the identification of appropriate methods for data analysis will be discussed.

Testing research hypotheses

Chow test and F statistic have initially been used to determine the method of using combined data and detect whether they are homogeneous or heterogeneous. The statistical hypothesis of this test are as follows:

$$\begin{cases} H_0 = \text{Pooled Data} \\ H_1 = \text{Panel Data} \end{cases}$$

H0 is based on lack of hidden personal effects and H1 is based on existence of hidden personal effects. If H0 is accepted, it means that the model lacks hidden personal effects. Thus, it can be estimated using regression model but if H1 is accepted, it means that the model has hidden personal effects.

If the results of this test show the usage of data in form of panel data, one of the models of fixed effects (FEM) or random effects (REM) must be used to estimate the model of research.

$$\begin{cases} H_0 = \text{Random Effect} \\ H_1 = \text{Fixed Effect} \end{cases}$$

Hausman null hypothesis is based on suitability of the random effects model to estimate the panel data of regression models.

Table 5: results of selecting a pattern to estimate model research

Model	Type of test	Statistic of test	Value for Statistic of test	Degree of freedom	Significance level	Result
1	F Limer test	F	0.723384	(5,20)	0.6138	Combined
	Hausman test	X ²	0.000000	10	1.0000	Random effects

According to the results F Limer test, its p- value is 0.6138 and H0 Hypotheses will be accepted at the confidence level of 95% and the model is require to be estimated using panel data. Also, based on Hausman test, its p-value is 1.000 which is more than 0.05 and H0 Hypotheses will be accepted at the confidence level of 95% and H1 hypothesis is rejected and the model is required to be estimated using random effects. The above model is estimated using panel data in form of random effects according to results obtained from F Limer and Hausman model tests and the results are shown in table 5.

Durbin-Watson test

This criterion focuses on the presence of serial correlation between errors and one of the important assumptions of regressions is that errors of model are not correlated to each other or in other words there is no self-serial correlation between them. Durbin-Watson statistic is used to test this hypothesis. If this statistic is equal zero, it shows a complete and positive self-correlation and if it is close to 4, it shows a complete and negative self-correlation. If it is 3, it shows the lack of self-correlation. Self-correlation shows that coefficient of determination has been estimated to be higher and variance of errors has been estimated to be lower than their actual values.

Assuming consistency residual variance

There are different methods to evaluate the similar variance in the linear regression model which are:

- 1) Glejser test
- 2) White test

- 3) Harvey test
- 4) Pagan Godfrey test

Pagan Godfrey test is used this analysis which is commonly used the detection of residual variance heterogeneity and the correct form of explanatory variables of regression equations. Absolute deviation of errors in mathematical equations have been used in this test. The result of this test has been provided in the following table.

$$\begin{cases} H_0 = \text{model has heterogeneity} \\ H_1 = \text{model does not have heterogeneity} \end{cases}$$

Results of selecting a pattern for consistency of variance of research model

As it can be observed in table 6, for Pagan Godfrey test, F and LM tests have been used to evaluate the existence of consistency in variance. F test is about evaluation of significance of model with this assumption that errors are normal while Lagrange coefficient test evaluates the significance of equation even if the model has abnormal distribution and states that error descriptions explain both asymptotic chi-square even if they are not normal. The null hypothesis in Godfrey test is that the variance of model errors is same. As it can be observed, the probs of F and LM statistics are greater than 5% and this shows that there is a consistency between vs and v will not be rejected.

Table 6: results of Regression analysis and variance of capital ratio

Variables	Correlation coefficients	SD	T statistic	Significant level
Development of banks BSD	1.202562	3.522476	0.341396	0.0023
Development of the market SMD	8.318541	3.829533	2.172207	0.0400
Degree of openness of economy TRADE	0.000643	0.000272	2.363970	0.0263
Degree of openness of market FDI	-0.014274	0.005987	-2.384165	0.0254
size of company SIZE	-0.009241	0.005082	-1.818378	0.0815
Cash LIQ	0.466276	0.375244	1.242594	0.2260
Net debt NLOAN	-0.000779	0.002081	-0.374339	0.7116

Variables	Correlation coefficients	SD	T statistic	Significant level
Return on assets ROA	0.029949	0.002130	14.06056	0.0000
Return on Equity ROE	-0.002176	0.000255	-8.533333	0.0000
Cost in revenue CIR	-0.001183	0.014498	-0.081597	0.9356
Determination coefficient	0.933319	Durbin-Watson statistic		2.135270
Adjusted coefficient of determination	0.905535	Lagrange - Godfrey coefficient		7.494075
Standard deviation of regression equation	0.007869	Significance level of Godfrey		0.7541
F statistic	33.59208	Test statistic		0.653888
Significance level of F statistic	0.000000			

In evaluation of significance of the model, since the significance level of F statistic is less than 0.05 (0.000000) (Prob <0.05), significance of the model is confirmed with the confidence level of 0.95. The determination coefficient of model also indicates that 0.933319% of changes in dependent variable is explained by the independent variable in the model. This changes the index of intensity of relation between variables. Standard deviation of regression equation indicates the level of variance of errors or residual of regression equation which is equal to 0.007869. One of the important assumptions of Regression is that errors of the model do not have correlation or in other words there is no self- serial correlation between them. Durbin-Watson test is used to test this hypothesis. This statistic is equal to 2.135270 which is between 1.5 and 2.5. Values close to 2 show a lack of self- correlation between residuals.

Interpretation of result of the first hypothesis

The first hypothesis: there is a relation between development of capital market and banks' capital ratio.

According to the results presented in Tables 6, significance level of prob statistic for SMD (development of market) is 0.0400 which is less than 0.05 and positive (8.31), thus it can be said that there is a relation between development of capital market and banks' capital ratio Durbin-Watson statistic is equal to 2.135270 which is between 1.5 and 2.5. Values close to 2 show lack of self- correlation of residuals which is another one of regression assumptions. Also, in evolution of significance of model, given that the probability of F statistic is equal to (0.0000) which is smaller than 0.05 (Prob <0.05.), the significance of the model is confirmed with confidence level of 0.95. Thus, the first hypothesis is confirmed.

Interpretation of result of the second hypothesis

The second hypothesis: there is a relation between development of banks and banks' capital ratio

According to the results presented in Tables 6, significance level of prob statistic for BSM (development of banks) is 0.0023 which is less than 0.05 and positive (1.20), thus it can be said that there is a relation between development of banks and banks' capital ratio. Thus, the second hypothesis is confirmed.

Conclusion

Two independent variable of "market development" and "development of banks" and the dependent variable of "capital ratio" and data compilation and random-effects models were used in line with first and second hypothesis of this research stating that "there is a relation between development of capital market and banks' capital ratio" and "there is a relation between development of banks and banks' capital ratio". The results showed there is a significant and direct relation between development of capital market and capital ratio of banks and thus, the first hypothesis was confirmed and also there is a relation between development of banks and banks' capital ratio and thus, the second hypothesis was confirmed. Thus, it can be concluded that market development is essential for economic growth and those who accept risks and invest in these markets will be successful.

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