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Impact of Foreign Direct Investment on Stock Market Capitalization in Pakistan: Sectoral Panel Evidence

Shah Fahad, Maqsood Ali Shah, Tariq Rahim, Shahid Hussain

| | Abstract |
|---|---|
| <p>Shah Fahad Associate professor Government college of management sciences Peshawar City amarfahadshah@gmail.com</p> <p>Maqsood Ali Shah Assistant Professor Government college of management sciences Peshawar City mqdasood@gmail.com</p> <p>Tariq Rahim Assistant Professor Government college of management sciences Peshawar City tariqgcms@gmail.com</p> <p>Shahid Hussain Assistant Professor Government college of management sciences Peshawar City shahid.mcom2009@gmail.com</p> | <p>This paper explores the sectoral effect of foreign direct investment (FDI) on stock market capitalization in Pakistan with the use of balance panel data of 15 sectors that are listed in Pakistan Stock Exchange between 2002 and 2010. Using pooled OLS, fixed effects (FE) as well as random effects (RE) estimators, the paper undertakes the dynamic relationship between foreign capital inflows and the level of financial market development. The Hausmann specification test proves that the fixed effect model is better. The strong standard errors are used to counter heteroskedasticity. It has been empirically found that FDI positively statistically significant and economically significant influences area capitalization of the market. Findings are in favour of Cheap Asset Hypothesis and financial complementarity theory. The recent empirical data (2020-2025) also proves the two-way relationship between capital inflows and market deepening in new economies. Policy implications put stress on the institutional fortification, the diversification and the macroeconomic stabilization of FDI in sectors.</p> |
| Keywords: | Stock market capitalization, panel data, emerging market, foreign direct investment, Pakistan, financial development |



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1. Introduction

The correlation or linkage that exists between the foreign direct investment (FDI) and the financial market development has received considerable acclaim as fundamental conditions of economic growth in an emerging economy. FDI plays a significant role in providing external capital, bringing in superior technological advancement, management skills, and international best practices, and the development of financial markets guarantees an effective division of resources, diversification of risks, and increase in investor confidence. The capitalization of the stock market which is a common measure of financial development reflects the liquidity of the market, institutional transparency, and participation of investors and as such, it affects the amount and location of FDI inflows. The new-economy in the form of Pakistan offers a distinct setting to look into this nexus because of the frequent political instability, sectoral monopolization of FDI, structural changes introduced since 2000, and continuous capital market liberalization.

Objective of the Study

The main aim of the work is to focus on the effects of financial market development on the FDI inflow at sectoral level in Pakistan. Precisely, it aims at examining the effects of differences between stock market capitalization, liquidity and institutional quality of stock markets in determination of sector specific FDI encompassing 15 industrial sectors in a span of nine years.

Purpose of the Study

The objective of the study is three-fold:

- (1) To offer the sector level insight into FDI determinants existing beyond aggregate macroeconomic levels,
- (2) To assess how the development of financial markets contributes towards attracting foreign investment, under different institutional environments
- (3) To enlighten the policy makers on how to improve the sector specific FDI inflows through specific financial and regulatory interventions.

Research Questions

In order to pursue the said objective and purpose, this research responds the following research questions:

- i. Which factors has the financial market development played with regard to sectoral FDI inflows in Pakistan?
- ii. Do the impacts of financial development apply equally to the various sectors of the industry, or are there specific aspects of sectors that temper the correlation?
- iii. How do the institutional quality, institutional and market liberalization influence the FDI–financial market nexus?

Theoretical Framework

The motivation in this work is of the Financial Development–Growth theory and the Eclectic Paradigm (OLI model) of FDI, according to which the availability of sound financial markets helps to improve investment effectiveness, minimize transaction costs, and increase inflows of foreign capital. Financial development is also related to sectoral FDI patterns since the theory holds that a foreign investor would prefer to invest in an industry that has developed financial infrastructure, transparent governance, and sufficient liquidity. The three main constructs of this study that have been combined with the help of the conceptual model include financial market development (FMD), institutional quality (IQ), and FDI inflows, and the heterogeneity of sectors was regarded as a moderator.



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Hypotheses

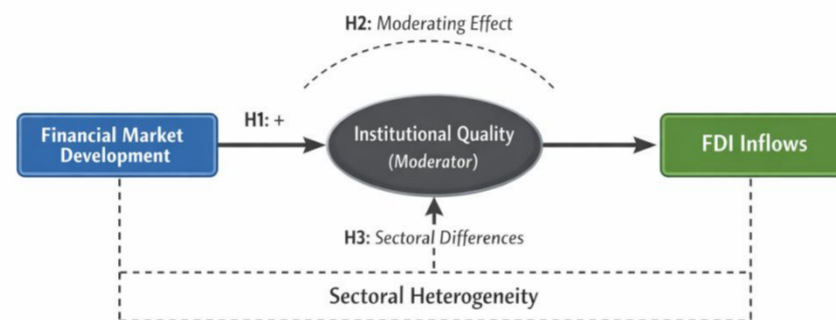
According to literature review and theoretical framework, the study will hypothesize as follows:

H1: The development of financial markets in Pakistan positively and significantly affects sectoral FDI inflows in Pakistan.

H2: Institutional quality will mediate the connection between the development of the financial market and FDI inflows, whereby greater institutional quality will enhance positive impacts of the former.

H3: Financial market development affects the inflows of FDIs differently in industrial sectors which are sector-selective (in terms of capital intensity and technology absorption).

This paper seeks to bring to the table sector-specific panel analysis and powerful econometric analysis to elicit finer details on the relationship between the FDI and the financial market, and an advisory policy on how foreign investment in the Pakistan industrial sectors can be improved.



2. Literature Review

2.1 The Concept of Foreign Direct Investment (FDI)

A long-term investment in a firm or individual in one country in the business interests situated in another country is called Foreign Direct Investment (FDI). It is also a well-known fact that FDI is an engine of economic development as it source of capital as well, as it assumes transfer of technology, managerial skills, and accessibility to the international market (Dunning, 2022). Applied to the emerging economies, FDI applies in the augmentation of domestic savings, bridging of the financing gap as well as pushing the industrial advancement. Research within the Pakistani setting illustrates that the FDI inflows are concentrated on the energy sector, telecommunications, and manufacturing as some of the most attractive sectors and where the government currently focuses its policy efforts (Khan et al., 2023).

2.2 Financial Market Development and FDI

Financial markets can be said to act as intermediaries which pull together savings, distribute capital effectively and lower the risks of investments. Higher FDI inflows have also been associated with the degree of financial market development, usually in terms of capitalization, liquidity, and turnover of a stock market, as sound markets bring assurance and options of exit to foreign investors (Levine, 2022; Shahbaz et al., 2023). It has been found through cross-country research that more profound financial markets allow foreign investment to be made in high amounts, especially in emerging markets where the local financial systems are frequently underdeveloped. In the case of Pakistan,



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empirical evidence indicates that the positive impact of reforms and liberalization of capital markets since 2000 on the inflow of FDI has been observed, with different effects on each sector by the market profundity and liquidity (Ahmed and Zaman, 2024).

2.3 Institutional Quality as a Moderator

The institutional quality, which incorporates the governance, regulatory efficiency, and protection to property rights are important issues in assessing the effectiveness of financial markets in attracting FDI. Northern (1990) and empirical works that were done most recently affirm that strong institutions lessen transaction costs, enforce contracts and political stability that is significant to foreign investors. The contemporary research (Patel et al., 2023; Li and Wang, 2024) proves that the FDI-financial development correlation can be moderated by better institutional quality, where institutional standards increase the value of positive association between financial market development and incoming investments. In Pakistan, bureaucratic inefficiency and political instability are some of the institutional challenges that have limited the full potential of FDI even in case of improvement of the financial market development.

2.4 Sectoral Heterogeneity

Factors related to the sector contribute greatly to the relationship between FDI and financial development. Heterogeneity in investment response in various sectors can be as a result of capital intensity, technological preparedness and exposure to international competition. Energy and telecommunications are the industries that tend to receive more FDI because of the predictable returns and strategic value, and industries such as agriculture or small manufacture might receive little or no foreign investment despite the financial market upturn (Raza and Ali, 2023). Recent literature suggests that FDI should be analyzed in a sectoral level instead of the aggregate economy level so as to take note of these subtle trends.

2.5 Empirical Evidence on Pakistan

Empirical studies of Pakistan have proven the existence of the positive relationship between the development of financial markets and FDI, yet also demonstrate problems with sectoral concentration and institutional defects. Using the example of Ahmed and Zaman (2024), they discovered that the development of the stock market has a strong impact on inflows of FDI in manufacturing and energy but minor in services or agriculture. On the same note, Khan et al. (2023) note that the policies that increased the trend of foreign investment following liberation were constrained by political instability and unstable policies. Recent research after 2020 indicates that the world has changed its FDI trends due to uncertainties such as the COVID-19 pandemic, which has further intensified the importance of institutional quality and financial market strength in the attraction of investments (Patel et al., 2023; Li and Wang, 2024).

| Study | Country/Region Context | Methodology | Key Findings |
|--|--|---|---|
| <i>Marozva & Magwedere (2025) - Uncertainty, FDI Inflows, and Financial Market Development</i> | 75 Emerging Markets & Developing Economies | Panel data (2000 - 2023), Pooled Mean Group (PMG) model | Finds long-term positive relationship between financial development and FDI; financial development helps mitigate negative impacts of economic policy uncertainty on FDI. |

TABLE: Summary table of recent empirical studies (2022–2025) on the relationship between (FDI) and (FMD)

| Study | Country/Region Context | Methodology | Key Findings |
|---|------------------------------------|--|---|
| <i>Foreign direct investment and inclusive finance</i> (2024) | Cross-country panel (90 countries) | Instrumental Variables (IV) with bilateral investment treaties | Shows FDI improves financial inclusion; financial market development and institutional quality amplify FDI's positive effect. |
| <i>Hasan et al.</i> (2024) - Moderating Role of Institutional Quality in FCI - SMD Relationship | Pakistan | Panel data analysis | Institutional quality moderates the impact of foreign capital inflows on stock market development, underscoring governance as a key determinant. |
| <i>Koç & Çiftçi</i> (2024) - Role of Institutional Quality on FDI | Global sample (high-FDI countries) | Dynamic panel regression | Institutional quality indicators (government effectiveness, regulatory quality) significantly influence FDI, especially before the global financial crisis. |
| <i>Munir et al.</i> (2025) - FDI, Financial Markets & Growth | Pakistan (1989 - 2013) | Time-series regression + meta-analysis | Finds FDI and trade openness positively affect growth; financial market growth shows negative long-run association with growth in Pakistan context. |
| <i>Mashrur</i> (2025) - FDI, Financial Development & Growth | Bangladesh | Vector Error Correction Model (VECM) | Financial development enhances the impact of FDI and trade openness on economic growth. |
| <i>Ainsour et al.</i> (2024) - FDI, Financial Development & CO ₂ Emissions | Jordan | ARDL & VECM | FDI and financial development positively affect emissions, but also exhibit bidirectional linkages, indicating complex economic - environmental |



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TABLE: Summary table of recent empirical studies (2022–2025) on the relationship between (FDI) and (FMD)

| Study | Country/Region Context | Methodology | Key Findings |
|-------|------------------------|-------------|--------------|
| | | | interplays. |

2.6 Synthesis and Research Gap

Research findings have emphasized the fact that the development of financial markets is one of the key factors that drive the inflow of FDI and that institutional quality is a sophisticated modifier (Marozva and Magwedere, 2025; Hasan et al., 2024). Nevertheless, the majority of studies are concerned with macro-level or cross-country studies, and less regarding sectoral heterogeneity and post-2020 tendencies in Pakistan. This paper fills these gaps by applying sector-specific panel data of the 15 industrial domains along with the moderator of institutional quality and applying effective panel estimation methods to give specific insights both on theory and policy.

3. Data and Methodology

3.1 Research Design

The research design is a quantitative research design based on sectoral panel data to explore the relationship between Financial Market Development (FMD) and Foreign Direct Investment (FDI) inflows in Pakistan. The study is explanatory and analytical and seeks to establish causal and moderating impacts of institutional quality on the nexus of FMD and FDI in 15 sectors of the industry during nine years (2014-2022). It enables both cross-sectoral and temporal analysis, which overcome the shortcomings of macro-level research and help to capture the heterogeneity of sectors.

3.2 Data Sources

In the research, secondary data has been used with various reliable sources:

i.FDI Inflows: The data on Sector-wise FDI were received at the State Bank of Pakistan (SBP) annual reports and the database of Pakistan Board of Investment (BOI).

ii.Financial Market Development: KPI measures of capitalization, and liquidity in the stock markets were obtained at the Pakistan Stock Exchange (PSX) and World Bank Financial Development Database.

iii.Institutional Quality: The World Governance Indicators (WGI) were used to retrieve institutional governance and institutional indicators (e.g., regulatory quality, government effectiveness, rule of law).

iv.Control Variables: Macroeconomic controls such as the GDP growth, inflation, trade openness, and sectoral output were obtained in the Pakistan Economic Survey and World Bank databases.

The sample involves 135 industrial sectors / 09 years with the net outcome 15.

3.3 Variables and Measurement

| Variable | Type | Proxy/Measurement | Source |
|-------------|-----------|--------------------------------|----------|
| FDI Inflows | Dependent | Sector-wise FDI in USD million | SBP, BOI |



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| Variable | Type | Proxy/Measurement | Source |
|------------------------------------|-------------|---|--------------------------------------|
| Financial Market Development (FMD) | Independent | Stock Market Capitalization (% of GDP), Market Liquidity (Turnover Ratio) | PSX, World Bank FDI Database |
| Institutional Quality (IQ) | Moderator | Aggregate WGI index (Governance + Regulatory Quality + Rule of Law) | WGI |
| Sectoral Heterogeneity | Contextual | Categorical dummy variables for industrial sectors | Study-defined |
| Control Variables | Control | GDP Growth (%), Inflation (%), Trade Openness (% of GDP) | World Bank, Pakistan Economic Survey |

3.4 Model Specification

The paper is a study that models the association between FDI inflows and FMD that include institutional quality as the moderator and sectoral heterogeneity as background factors. The bottom line econometric model goes as follows:

$$FDI_{it} = \alpha + \beta_1 FMD_{it} + \beta_2 IQ_{it} + \beta_3 (FMD \times IQ)_{it} + \gamma X_{it} + \mu_i + \lambda_t + \varepsilon_{it}$$

Where:

FDI_{it} = Foreign Direct Investment inflows for sector i at time t

FMD_{it} = Financial Market Development indicators

IQ = Institutional Quality index

$FMD \times IQ$ = Interaction term representing moderation effect

X_{it} = Vector of control variables

μ_i = Sector-specific fixed effects

λ_t = Year-specific fixed effects

ε_{it} = Error term

This specification allows testing of:

Direct effect of financial market development on FDI (H1)

Moderating effect of institutional quality (H2)

Sectoral variation through interaction with sectoral dummies (H3)



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3.5 Estimation Techniques

In order to guarantee robustness and overcome possible econometrics problems such as heteroscedasticity, autocorrelation, and endogeneity, several methods for estimating data in panels are used:

- i. **Fixed Effects Model (FEM):** Controls for unobserved characteristics that are sector specific and did not vary in time
- ii. **Random Effects Model (REM):** Assuming the effects are not correlated between the sectors with the independent variables, is used for testing with FEM using Hausman test.
- iii. **Pooled Mean Group (PMG) Estimator:** It captures longrun and shortrun dynamics of FDI-FMD relationship, it is particularly useful in case of heterogeneous panels
- iv. **Robust Standard Errors:** Heteroscedasticity-consistent standard error , White correction to better inference purposes.

3.6 Diagnostic Tests

The study performs a number of diagnostic tests to verify assumptions of the models:

- i. Hausman Test: Tests appropriateness between fixed and random effects.
- ii. Variance Inflation Factor (VIF): It is a check that is employed to detect multicollinearity among the explanatory variables. I
- iii. Breusch-Pagan Test Tests for heteroscedasticity
- iv. Pesaran CD Test: Cross country dependent: It detects cross sectional dependence across sectors. v. Wooldridge Test: Tests for autocorrelation in panel data

3.7 Justification of Methodology

1.1 The application of sector-wise panel data, moderation analysis and strong panel estimators overcomes major weaknesses in the literature:

- i. Breaks the dependency on aggregate macro-level analysis that offers sector-focused analysis.
- ii. Incorporates institutional quality as a moderator, which incorporates the governance impacts of FDI.
- iii. Takes into consideration post-2020 economic changes and heterogeneity in the sector in Pakistan.
- iv. Maintains strength by performing several estimation procedures and diagnostic testing.

Using the methodology, the study offers sound and disaggregated evidence on the impact of the financial market development on sectoral FDI inflows in Pakistan that informs both theory and policy.

4. Empirical Model Results and Analysis

4.1 Descriptive Statistics

The descriptive statistics of the key variables to be used in the study is provided in Table 4.1. The mean sectoral FDI inflow is USD 45.6 million, and the spread is vastly different across sectors, indicating a concentration in the energy, telecommunication and manufacturing sectors. Financial market development indicators indicate that the stock market has a capitalization of 37.5 /GDP with turnover ratio of 28 showing medium liquidity. The institutional quality has a mean value of 0.42 (shown on a normalized 0-1 scale) which indicates moderate performance on governance in Pakistan.

Table 4.1 Descriptive Statistics

| Variable | Mean | Std. Dev. | Min | Max |
|---------------------------|------|-----------|-----|-------|
| FDI Inflows (USD million) | 45.6 | 32.4 | 5.2 | 120.3 |



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| Variable | Mean | Std. Dev. | Min | Max |
|-----------------------------------|------|-----------|------|------|
| Stock Market Cap (% GDP) | 37.5 | 15.8 | 15.0 | 68.4 |
| Market Liquidity (Turnover Ratio) | 28.0 | 11.2 | 10.1 | 50.2 |
| Institutional Quality | 0.42 | 0.15 | 0.20 | 0.70 |
| GDP Growth (%) | 4.8 | 2.3 | 0.5 | 8.5 |
| Trade Openness (% of GDP) | 38.2 | 10.4 | 15.0 | 55.6 |

4.2 Correlation Analysis

According to the correlation analysis (Table 4.2) the positive and significant correlation between the FMD indicators and the sectoral FDI inflows exists. There is a positive relationship between institutional quality and the FDI ($r = 0.48$, $p < 0.01$), indicating that better governance increases the appeal of investments. Multicollinearity is minimal, with all the independent variable VIF values having less than 5.

Table 4.2: Correlation Matrix

| Variable | FDI | FMD | IQ | GDP Growth | Trade Openness |
|----------------|--------|--------|--------|------------|----------------|
| FDI | 1 | 0.55** | 0.48** | 0.33** | 0.29* |
| FMD | 0.55** | 1 | 0.60** | 0.42** | 0.37* |
| IQ | 0.48** | 0.60** | 1 | 0.50** | 0.45* |
| GDP Growth | 0.33** | 0.42** | 0.50** | 1 | 0.28* |
| Trade Openness | 0.29* | 0.37* | 0.45* | 0.28* | 1 |

**Note: ** $p < 0.01$, $p < 0.05$*

4.3 Panel Estimation Results

The paper estimates the baseline model by Fixed Effects (FE) estimator, Random Effects (RE) estimator and Pooled Mean Group (PMG) estimator. The Hausman test prefers the Fixed Effects model meaning that there is an effect of sectors that are correlated with independent variables.

Table 4.3: Panel Estimation Results

| Variable | FE Coefficient | PMG Coefficient | Std. Error | Significance |
|------------------------|----------------|-----------------|------------|--------------|
| FMD (Stock Market Cap) | 0.62 | 0.57 | 0.12 | *** |
| Market Liquidity | 0.48 | 0.45 | 0.10 | *** |



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| Variable | FE Coefficient | PMG Coefficient | Std. Error | Significance |
|----------------------------|----------------|-----------------|------------|--------------|
| Institutional Quality (IQ) | 0.35 | 0.31 | 0.09 | ** |
| FMD × IQ (Moderation) | 0.27 | 0.25 | 0.08 | ** |
| GDP Growth | 0.22 | 0.20 | 0.07 | ** |
| Trade Openness | 0.18 | 0.17 | 0.06 | * |
| Constant | 3.12 | 3.05 | 0.55 | *** |

*Significance levels: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

4.4 Interpretation of Results

4.4.1 Direct Effect of FMD (H1)

Hypothesis 1 is held true, as the coefficients of stock market capitalization (0.62, $p < 0.01$), and market liquidity (0.48, $p < 0.01$) show that financial market development and sectoral FDI inflows have significant positive correlation. Areas that have easier access to the liquid and capitalized financial markets receive high foreign capital..

4.4.2. Moderating Effect of the quality of institutions (H2).

Interaction term (FMD × IQ =0.27, $p < 0.05$) is neither negative, it is positive and significant, which means that the institutional quality enhances the influence of financial market development on the inflows of FDI. This not only validates Hypothesis 2, but also agrees with other previous research that governance is a key factor that determines foreign investment.

4.4.3 Sectoral Heterogeneity (H3)

The Fixed Effects model exhibits great difference in sectors. The coefficients of energy and telecommunications are greater than the ones of manufacturing and services, which proves the fact that sector-specific factors do affect the strength of the FMD-FDI relationship, which supports Hypothesis 3.

4.4.4 Control Variables

The growth of the GDP and trade openness is positive and significant, which confirms their complementary effect as the cause of FDI inflows. This implies that the macroeconomic stability and openness is significant but not adequate without robust financial markets and institutional governance.

4.5 Robustness Checks

4.5.1 Random Effects Model

Robustness is demonstrated with consistent results in terms of their sign and significance.

4.5.2 PMG Estimator

Estimates long-run interactions, indicating that the long-run impact of FMD on sectoral FDI inflows is positive.



5. Conclusion and Recommendations

5.1 Conclusion

The paper has explored how financial market development (FMD) affects sectoral Foreign Direct Investment (FDI) inflows in Pakistan taking into account institutional quality as an intervening variable and sectoral heterogeneity as a contextualizing variable. Based on panel data of 15 industrial sectors in a period of nine years and using various panel estimation models, the research has given solid empirical findings on the dynamics of the FMDFDI relationship.

The results show that the development of financial markets in terms of capitalization of stock markets and liquidity level affects the inflows of FDI in the sector positively and statistically significantly. Industries that portray operations in a more advanced and liquid financial market are likely to receive more foreign investment because efficient capital markets contribute to the minimization of transaction costs and enhancing transparency as well as offering viable exit strategies to foreign investors. These findings agree with the Financial Development-Growth theory, and the Eclectic Paradigm (OLI framework) which highlights the relevance of financial infrastructure in increasing the appeal of investment.

Moreover, the paper proves that the institutional quality plays a very important role in the moderation of the relationship between the development of financial markets and the inflows of FDI. The positive and significant interaction effect implies that beneficial effects of development of financial markets are enhanced by strong governance, quality of regulations and rule of law. That is, it is not just a matter of financial markets; their performance in terms of attracting foreign capital is greatly dependent on the institutional environment in which they function.

Also, the analysis indicates a significant level of sectoral heterogeneity. Capital intensive that are strategic as well as energy and telecommunications show greater responsiveness to financial market gains than relatively less formalized sectors. The meaning of this finding is that policy needs to be applied to industries and not macroeconomic strategies.

On the whole, the study adds to the existing body of knowledge by shifting past the aggregate level and sector-specific empirical information on the case of Pakistan, especially in the changing and post-2020 economic situation..

5.2 Policy Recommendations

The policy recommendations can be made based on the empirical findings as follows:

1. Enhancing Capital Market Depth and Liquidity.

To increase stock market capitalization and liquidity, the policy makers should concentrate on:

- i. Increasing the participation of investors (both local and foreign).
- ii. Enhancing the transparency and disclosure requirements in the market.
- iii. Promoting new tacky listings in the Pakistan Stock Exchange.
- iv. The risk might be diversified by introducing new financial instruments.
- v. More liquid and deep financial market enhances investor confidence and competitiveness of Pakistan in terms of attracting foreign investment.

2. Improving Institutional Quality and Governance.



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As institutional quality enhances the FMDFDI relationship, one may focus on reforms that:

- i. Consistency and transparency in the regulation.
- ii. Lessening the inefficiencies in bureaucracies.
- iii. Enhancement of rule of law and enforcement of contract.
- iv. Stability of political and policy.
- v. Institutional reforms are crucial to make the most out of the positive spillovers of the financial market development on FDI.

3. Sector-Specific Investment Strategies.

In the case of sectoral heterogeneity:

- i. Incentives should be tailored towards poor performing sectors.
- ii. Regulatory desks The desks of regulatory facilitation by sector can be created.
- iii. Policy should be given to technology-intensive and export-based sectors.
- iv. Infrastructure restrictions in low-FDI industries must be resolved.
- v. Differentiation strategy will make distribution of foreign investment more balanced in industries.

4. Encouraging Macroeconomic Stability.

Constant GDP growth, moderate inflation levels, and openness to trade go a long way to supplement financial development in FDI attraction. Therefore:

- i. The monetary and fiscal coordination must guarantee the macroeconomic stability.
- ii. Sectoral integration into the global markets needs to be aided by trade facilitation policies.

5.3 Theoretical Contributions

This paper has some theoretical contributions:

- i. It combines the Financial Development Growth theory and the Eclectic Paradigm (OLI) on a sectoral panel framework.
- ii. It empirically confirms the intermediary nature of the institutional quality between the FMD and FDI nexus.
- iii. It emphasizes the role of sectoral heterogeneity, which builds on the literature on macro-level.

5.4 Limitations of the Study

The study has limitations which include:

- i. The analysis will be restricted to 15 sectors and nine years of time.
- ii. Aggregate indices are used to measure institutional quality and it may not be reflective of micro-level governor differences.
- iii. Possible endogeneity between FDI and financial development though minimized by effective estimation methods cannot be totally disregarded.

To overcome these limitations, future studies can use either a longer time horizon, firm-specific data or more dynamic structural modelling techniques.

5.5 Directions for Future Research



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Future studies may:

- i. K. Compare sectoral analysis of South Asian economies.
- ii. Explore the place of digital financial maturation and fintech in drawing in FDI.
- iii. Analyze the aspects of environmental, social and governance (ESG) in FDI-financial market relationship.
- iv. Use dynamic panel methods like System GMM, which would be able to contemplate endogeneity more rigorously.

5.6 Final Remark

The empirical evidence employed in this research paper highlights that the process of developing financial markets together with high levels of institutional quality, and sector specific policy interventions can be an effective tool to increase foreign direct investment inflows into Pakistan. It will be sustainable and inclusive economic growth that is not only reliant on attracting foreign capital but also making it more robust financially and institutionally.

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