**Effect of financial development on innovation: roles of market institutions**

ABSTRACT

Studies show that the impact of financial markets on innovation is mixed. This paper examines whether financial development can help explain the pace of innovation in 68 developed and developing countries during 1995–2018. By utilizing panel data and incorporating market institutions (market creating, market regulating, market stabilizing, and market legitimizing), we discovered a nonlinear effect in the finance–innovation relationship. Market institutions would enhance such a relationship, and the credit and equity market development levels are beneficial to a country's innovation only up to a certain threshold. The findings reveal a difference between developed and developing countries in terms of innovation, and more innovation activities are observed after the 2007–2009 global financial crisis.

**Keyword:** Financial development; Institutions; Innovation; Nonlinearity; Dynamic system panel GMM; Regression discontinuity design