

An Empirical Analysis of the Impact of the Nigerian Capital Market on Her Socio-economic Development

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ABSTRACT The objective of this study was to empirically analyze the impact of the Nigerian capital market on her socio-economic development from 1981 to 2008. The socio-economic development was proxy by the gross domestic product (GDP) while the capital market variables considered included market capitalization, total new issues, volume of transaction and total listed equities and Government stock. Using the ordinary least square it was found that the capital market indices have not impact significantly on the GDP. The government is therefore advised to put up measures to stem up investors' confidence and activities in the market so that it could contribute significantly to the Nigerian socio-economic development.

INTRODUCTION

The capital market has been identified as an institution that contributes to the socio-economic growth and development of emerging and developed economies. This is made possible through some of the vital roles played such as channeling resources, promoting reforms to modernize the financial sectors, financial intermediation capacity to link deficit to the surplus sector of the economy, and a veritable tool in the mobilization and allocation of savings among competitive uses which are critical to the growth and efficiency of the economy (Alile 1984). It helps to channel capital or long-term resources to firms with relatively high and increasing productivity thus enhancing economic expansion and growth (Alile 1997). Ekundayo (2002) argues that a nation requires a lot of local and foreign investments to attain sustainable economic growth and development. The capital market provides a means through which this is made possible. However, the paucity of long-term capital has posed the greatest predicament to economic development in most African countries including Nigeria.

Osaze (2000) sees the capital market as the driver of any economy to growth and development because it is essential for the long-term growth capital formation. It is crucial in the mobilization of savings and channeling of such savings to profitable self-liquidating investment. The Nigerian capital market provides the necessary lubricant that keeps turning the wheel of the economy. It not only provides the funds required for investment but also efficiently

allocates these funds to projects of best returns to fund owners. This allocative function is critical in determining the overall growth of the economy. The functioning of the capital market affects liquidity, acquisition of information about firms, risk diversification, savings mobilization and corporate control (Anyanwu 1998). Therefore, by altering the quality of these services, the functioning of stock markets can alter the rate of economic growth (Equakun 2005). Okereke-Onyiuke (2000) posits that the cheap source of funds from the capital market remain a critical element in the sustainable development of the economy. She enumerated the advantages of capital market financing to include no short repayment period as funds are held for medium and long term period or in perpetuity, funds to state and local government without pressures and ample time to repay loans.

In 1986 Nigeria embraced the International Monetary Fund (IMF)-World Bank Structural Adjustment Programme (SAP) which influenced the economic policies of the Nigerian government and led to reforms in the late 1980s and early 1990s. The programme was proposed as an economic package to rapidly and effectively transformed the Nigerian economy within two years (Yesufu 1996). However, until SAP was abandoned in 1994, the objectives were not achieved due to the inability of government to judiciously implement some of its policy measures (Oyefusi and Mogbolu 2003). The notable reforms include monetary and fiscal policies, sectoral reforms such as removal of oil subsidy in 1988 to the tune of 80%, interest deregulation from August 1987, financial market reform and public sector

reforms which entails the full or partial privatization and commercialization of about 111 public owned enterprises. The Nigerian Stock Exchange was to play a key role during the offer for sale of the shares of the affected enterprises (World bank 1994; Anyanwu 1993; Anyanwu et al. 1997; Oyefusi and Mogbolu 2003). The introduction of SAP in Nigeria has resulted in a very significant growth of the country's stock market as a result of deregulation of the financial sector and the privatization exercise which exposed investors and companies to the significance of the stock market (Alile 1996; Soyode 1990). Ariyo and Adelegan (2005) contend that the liberalization of capital market led to the growth of the Nigerian capital market yet its impact at the macro-economy was negligible. Again the capital market was instrumental to the initial 25 banks that were able to meet the minimum capital requirement of N25 billion during the banking sector consolidation in 2005. The stock market has helped government and corporate entities to raise long-term capital for financing new projects, and expanding and modernizing industrial / commercial concerns (Nwankwo 1991).

Given the roles the capital market has played during the privatization of public owned enterprises, recent recapitalization of the banking sector and avenue of long term funds to various government and corporations in Nigeria. The objective of this paper is to find out whether the Nigerian capital market has made significant impact on the socio-economic development of Nigeria between 1981 and 2008. The rest of the paper is divided into the five sections. The next section is the review of literature and theoretical framework. Section three deals on the method employed by the study. Section four is the discussion and conclusion. The conclusion and recommendation is in section five while the last section is the summary.

2. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

There have been the growing concerns and controversies on the role of the Stock markets on economic growth and development (Oyejide 1994; Levine and Zervos 1996; Demirgüç-kunt and Levine 1996; Nyong 1997; Obadan 1998; Sule and Momoh 2009; Ewah, Esang and Bassey 2009). There have been mixed results; while some are in support of a positive link, some negative

link and others do not find any empirical evidence to support such conclusion. For instance, Atje and Jovanovic (1993) found in a cross-country study of stock and economic growth of 40 countries from 1980 to 1988 that there was a significant correlation between the average economic growth and stock market capitalization. Levine and Zervos (1996) examined whether there was a strong empirical relationship between stock market development and long-run economic growth. They found a strong correlation between overall stock market development and long-run economic growth.

Demiurgic-Kunt and Levine (1996) using data from 44 countries for the period 1986 to 1993 found that different measures of stock exchange size are strongly correlated to other indicators of activity levels of financial, banking, non-banking institutions as well as to insurance companies and pension funds. They concluded that countries with well-developed stock markets tend to also have well-developed financial intermediaries. Again, Demiurgic-Kunt and Maksimovic (1998) have shown and re-emphasized the complementary role of the stock market and banks that they were not rival or alternative institutions using 30 countries from 1980 to 1991. Levine and Zervos (1998) used pooled cross-country time series regression of 47 countries from 1976 to 1993 to evaluate whether stock market liquidity is related to growth, capital accumulation and productivity. They towed the line of Demiurgic-Kunt and Levine (1996) by conglomerating measures such as stock market size, liquidity and integration with world market, into index of stock market development. The rate of Gross Domestic Product (GDP) per capita was regressed on a variety of variables designed to control for initial conditions, political instability, investment in human capital and macro economic condition and then, included the conglomerated index of stock market development. They found empirically that the measures of stock market liquidity were strongly related to growth, capital accumulation and productivity while stock market size does not seem to correlate to economic growth.

Nyong (1997) developed an aggregate index of capital market development and used it to determine its relationship with long-run economic growth in Nigeria. The study employed a time series data from 1970 to 1994. Four measures of capital market development-ratio of market capitalization to GDP (in %), ratio of total value of

transactions on the main stock exchange to GDP (in %), the value of equities transactions relative to GDP and listing were used. The four measures were combined into one overall composite index of capital market development using principal component analysis. The financial market depth was included as control. It was found that the capital market development is negatively and significantly correlated with the long-run growth in Nigeria. Demiurgic-Kunt and Maksimovic (1998) cited in Henry (2000) found a relationship between economic growth and the stock market activity in the field of transmission of security (secondary market) more than in funds channeling (primary market). Barlett (2000) demonstrated that a rising stock price raises the wealth of the economy (wealth effect) by encouraging increase in consumers consumption and increase in investment. Ewan et al. (2009) appraise the impact of the capital market efficiency on the economic growth of Nigeria using time series data from 1961 to 2004. They found that the capital market in Nigeria has the potential of growth inducing but it has not contributed meaningfully to the economic growth of Nigeria because of low market capitalization, low absorptive capitalization, illiquidity, misappropriation of funds among others. Harris (1997) did not find hard evidence that stock market activity affects the level of economic growth.

2.1 Roles of the Capital Market

According to Al-Faki (2006), the capital market is a “network of specialized financial institutions, series of mechanisms, processes and infrastructure that, in various ways, facilitate the bringing together of suppliers and users of medium to long term capital for investment in socio-economic developmental projects”. The capital market is divided into the primary and the secondary market. The primary market or the new issues market provides the avenue through which government and corporate bodies raise fresh funds through the issuance of securities which is subscribed to by the general public or a selected group of investors. The secondary market provides an avenue for sale and purchase of existing securities. Sule and Momoh (2009) found that the secondary market activities have impacted more on Nigeria per capita income by tending to grow stock market earnings through wealth than the primary market.

The roles of the capital market in the development of the economy include:

- (1) It provides opportunities for companies to borrow funds needed for long-term investment purposes.
- (2) It provides avenue for the marketing of shares and other securities in order to raise fresh funds for expansion of operations leading to increase in output/production.
- (3) It provides a means of allocating the nations real and financial resources between various industries and companies. Through the capital formation and allocation mechanism the capital market ensures an efficient and effective distribution of the scarce resources for the optimal benefit to the economy.
- (4) It reduces the over reliance of the corporate sector on short term financing for long term projects and also provides opportunities for government to finance projects aimed at providing essential amenities for socio-economic development.
- (5) The capital market can aid the government in its privatization programme by offering her shares in the public enterprises to members of the public through the stock exchange.
- (6) The capital market also encourages the inflow of foreign capital when foreign companies or investors invest in domestic securities, provides needed seed money for creative capital development and acts as a reliable medium for broadening the ownership base of family-owned and dominated firms.

2.2 Contribution of the Capital Market to Socio-economic Development of Nigeria

The capital market is very vital to the growth, development and strength of any country because it supports government and corporate initiatives, finances the exploitation of new ideas and facilitates the management of financial risk. The rate of economic growth has been inexorably linked to the sophistication of the financial market and capital market efficiency. Both markets facilitate the mobilization and channeling of funds into productive constituents and ensuring that the funds are used for the pursuit of socio-economic growth and development without being idle (Akinbohunbe 1996; Adebisi 2005)

From 1961, the Nigerian capital market has grown tremendously, particularly during the periods of the indigenization decrees of 1972 and

1977. The securities increased from 8 in 1961 to about 301 in 2008. Over the years, the Nigerian capital market has witnessed relatively stability and also recorded impressive growth. This has positioned it to positively impact the economy. There is clear evidence that the capital market remained an important source of capital for the nation's economic development in financing infrastructural projects, the privatization programme of the government and banking sector recapitalization in Nigeria. Sule and Momoh (2009) conclude that the recent consolidation exercise of major financial institutions and privatization exercise of most publicly owned enterprises are key indications of government faith in the capital market to drive growth of the Nigerian economy.

2.2.1 Financing Government's Infrastructural Projects

The capital market has been a viable source of financing state and local government infrastructural projects and developmental strides with less pressures and lean on resources. The first State to use the capital market was the defunct Bendel State which issued a ten year N20 million 7% Bendel State of Nigerian Loan Stock in 1978. The maturity was in 1988 (Okereke-Onyiuke 2000). The issue was to finance a housing project. Ogun State went to the market in 1986 to raise a N15 million 12% First Ogun State Government Loan Stock with a maturity date of 1996. The bond was issued to finance the construction of a water project in Abeokuta. The Lagos State Government accessed the capital market in 1987 and 1988 with two tranches of its revenue bond for the development of the first and second phase of the Lekki peninsula. The first tranche was N30 million while the second tranche was N60 million or an aggregate of N90 million raised by the Lagos state government.

Oyo State Government raised 16.5% N 30 billion Revenue Bond in 1999 to build the Gbagi market and the Adamasingba complex. Also, the Kaduna State Government raised N30 million each from the market in 1989 and 1993 to finance the development of the Kadia Ginger processing factory. Edo State Government went to the market to raise the first Edo State 21% N500 million Floating Rate Revenue Bond 2002/2006. It was used to finance the renovation the Samuel Ogbemudia stadium and other projects. Lagos Island Local Government has also tapped from

the capital market to finance a shopping complex – the Sura shopping complex. The bond carried a total amount of N100 million and an interest rate of 24.75% (SEC 2002).

Over the years, some States have gone to the capital market to source for funds to finance their developmental projects. For instance, Yobe State raised N2.5 billion in 2001 to finance urban roads, houses and drainage improvement. Ekiti State raised N4 billion in 2002 to finance the construction and rehabilitation of some of its urban and rural roads, establishment of palm plantation, rural electricity and expansion of water project. Lagos State raised N15 billion in 2003 to refinance short term facilities obtained from banks to fund developmental projects. Cross River State raised N4 billion to upgrade and expand Obudu Ranch Resort. Akwa-Ibom State raised N6 billion to finance infrastructural development, Delta State raised N5 billion to finance market, Health care, water and education and Edo State raised N1 billion to finance development of Ogba Riverside Housing Estate. Osaze (1995) while bemoaning the low level at which State and local Governments sought funds from the market stressed the capital market could also be a veritable source of funding for the cash-trapped Nigerian universities yet to be harnessed.

2.2.2 Privatization of State Owned Enterprises (SOEs)

The Nigerian Capital Market played a paramount role in the privatization of the State Owned Enterprises by giving creditability and transparency to the exercise. Within four of the privatization and commercialization decree, 88 were privatized out of 111 SOEs realizing a gross proceeds of N3.7 billion (Anyanwu et al. 1997). Between 1989 and 2001, a total of N25.6 billion was realized from the exercise. Also, the shares of the SOEs were sold to Nigerians and associations in all local government through public offers

2.2.3 Bank Re-capitalization and Consolidation in Nigeria

The bank recapitalization to N25 billion in which 25 banks (but presently 24 banks after Stanbic and IBTC bank merged) emerged from the previous 89 banks clearly revealed the importance of the capital market. In fact, most of the banks in Nigeria were able to raise the required

capital after going to the capital market through initial public offerings. Soludo (2006) reports that about \$650 million was invested in the banking sector in 2005. Al Faki (2006) puts the figure that was raised from the capital market by banks to meet the minimum capital requirement of ₦25 billion as over ₦406.4 billion.

2.3 Analysis of the Nigerian Capital Market Performance

The Nigerian capital market has performed fairly despite the numerous challenges and problems some of which include: the buy and hold attitude of Nigerians, massive ignorance of a large population of the Nigerian public of the nature and benefits of the capital market, few investment outlets in the market, lack of capital market friendly economic policies and political instability, private sector led economy and less than full operation of recent developments like the Automated Trading System (ATS), Central Securities Clearing System (CSC), On-line and Remote Trading, Trade Alerts and Capital Trade Points of the Nigerian Stock Exchange.

2.3.1 Total New Issues

The total new issues before 1989 was below N1 billion. However, from 1989 to 1996 it hovered between N1 billion to N10 billion. The amount crossed the N10 billion marks in 1997. For instance, between 1996 and 2001, a total of 172 new issues (securities of public companies amounting to N56.40 billion) were floated in the capital market. The total new issues were valued at N5.85 billion in 1996 but it rose by about 532% to N37.198 billion in 2001. Total new issues was N61, 284 billion, in 2002, N180, 079.9 billion in 2003. N195,418.4b in 2004 and N552,782b in 2005. It crossed the trillion mark in 2007 being N1.935 trillion that year but fell to N1.509 trillion in 2008. (see Appendix 1)

2.3.2 Market Capitalization

This is the most widely used indicator in assessing the size of a capital market to an economy. In a bearish market the market capitalization falls and vice versa for a bullish market. Before 1988, the total market capitalization was less than N10 billion from 1988 to 1994. It hovered between N10 billion to N57 billion. In

2003 it was N1,3593 trillion, N2.1125 trillion in 2004 and N5.12 trillion in 2006. The market capitalization recorded the highest value of N13.2294 trillion in 2007. But this fell to N9.562 trillion in 2008 due to the global financial meltdown. The percentage market capitalization compared to the economy's Gross Domestic Product (GDP) helps to assess the size of the stock market. In 1981, this was 10.5%, but fell to 7.4% in 1994. It rose again to 9.3% in 1995, 10.6% in 1996; 18.9% in 2003, 25.6% in 2004 and 27.4% in 2005

2.3.3 Listed Securities

The number of equities listed increased from 3 in 1961 to 13 in 1971, 93 in 1981 in 2001 and 198 in 2005. For the SSM, it was 1 in 1985 and 20 in 1995. After falling from 23 in 1993, it fell to 19 in 1997 and from then to 2005 it remains at 16. The total securities increased from 8 in 1961 to 60 in 1971; 194 in 1981, 23 in 1991, 261 in 2001, 288 in 2005 and 301 in 2008. It would be observed the total listed securities is still low despite almost 50 years of the existence of the Nigerian Stock Exchange.

2.3.4 Value of Transactions

From 1961 to 1975, the annual value of the NSE was below N100 million. However, from 1976 to 1994 it was between N100 million and N600 million. In 1995, the trading value crossed N1 billion. It was N120.70b billion in 2003, N225,820.5 billion in 2004 and N4,4 trillion in 2008. From 1961 to 1994, Government Stock dominated the market between 58.91% and 99.5% whereas from 1995 the industrial securities continue to dominate the market.

3. RESEARCH METHODOLOGY

The period of study of the Nigerian capital market is from 1981 to 2008. The data were collected from the Nigerian Stock Exchange (NSE), Fact Books, Security and Exchange Commission (SEC) Market Bulletins and Central Bank of Nigerian (CBN) statistical bulletins. The multiple regression analysis was used to test whether the capital market indices (Market Capitalization, Total New Issues, Total Value of Transaction and Total Listed Equities and Government stock) have impacted on the socio-economic development of Nigeria, proxy by Gross Domestic Product (GDP).

3.1 Model Specification

The model is based on Demirgüç-Kunt and Levine (1996), Levine and Zervos (1996), Demirgüç-Kunt et al. (1996) and Ewah et al. (2009) which have investigated linkage between stock market and economic growth. Model which specifies that the socio-economic development (proxy by Gross Domestic Product) is significantly influenced by the capital market indices (market capitalization, new issues, value of transaction and total listing) is formulated as follows:

$$GDP = F(MCAP, TNI, VLT, LEGS)$$

$$GDP = a + a_1 MCAP + a_2 TNI + a_3 VTS + a_4 TLS + U$$

Where the apriori expectation is: $a_1, a_2, a_3, a_4 > 0$ and

GDP = Gross Domestic Product, $MCAP$ = Market capitalization, TNI = Total New Issues, VLS = Total value of transactions, TLS = Total listed Equities and Government Stock, U = Disturbance Term, a = Intercept, $a_1 - a_4$ = coefficient of the independent variables

3.2 Regression Result

The result obtained using the Ordinary Least Square (OLS) estimation technique.

$$GDP = 0.5093MCAP - 0.1666TNI + 0.0077VTS + 1919.7TLS - 2034$$

(0.9405) (-0.4409) (0.2326)
(3.1822)* (-1.3381)

$$R^2 = 0.7722, R^2 = 0.7326 \quad F(4,23) = 19.49^*$$

DW statistic = 0.8084

T-values are in parenthesis * significant at 5 %

4. DISCUSSION AND CONCLUSION

The regression result reveals that about 77.22% of the systematic variation in the dependent variables is explained by the four independent variables i.e. market capitalization (MCAP), total New Issues (TNI), value of transaction (VLT) and total listed equities and Government Stock (TLEG). The F value is significant at the 5% level showing that there is a linear relationship between the GDP and the four independent variables. On the basis of apriori expectation, only the coefficient of the total new issues had negative sign. The others were correct and positively signed.

In fact a unit increase in TLS results in an

increase in the GDP by 1919.7 units. The implication is that the economy responds favorably to measures taken to increase total listing of equity and government stock in the Nigerian Stock Exchange. Similarly, a unit increase in MCAP and VTS increases the GDP by 0.0509 and 0.0077 respectively. Only the t-values of TLS is statistically significant at 5% level. This may not be the recent moves to encourage listing in the market. The t-value of TNI of -0.4409 has not made any significant impact on the economic growth. The negative impact of TNI may not be unconnected with the yet shallow mature of the Nigerian capital market even though total new issues tend to have improved remarkably since the banking consolidation in 2005.

It was found that the market capitalization and value of transaction had positive but insignificant impact on the GDP whereas the total new issues had a negative influence on GDP. However, the total listing was positively signed and also statistically significant. The findings agree with Ariyo and Adelegan (2005) and Ewah et al. (2009) who found that the capital market in Nigeria has the potentials for growth inducing but has not contributed meaningfully to the economic growth of Nigeria due to low market capitalization, small market size, few listed companies low volume of transactions, low absorptive capitalization, illiquidity etc. Also our result supports Demirgüç-Kunt and Asli (1996) and Harris (1997) who found no hard evidence and strong positive relationship between stock market and economic growth and is contrary to the literatures that there is positive relationship between stock market and economic growth.

5. CONCLUSION AND RECOMMENDATIONS

In order for the Nigerian capital market to be a pivotal force in Nigeria socio-economic growth and development, the following suggestions are put forward: First, improvement in the declining market capitalization by encouraging more foreign investors to participate in the market, maintain state of the art technology like automated trading and settlement practices, electronic fund clearance and eliminate physical transfer of shares. There is also need to restore confidence to the market by regulatory authorities through ensuring transparency and fair trading transactions and dealings in the stock exchange. It must also

address the reported cases of abuses and sharp practices by some companies in the market. Moreover, the total listing in the NSE is still a far cry compare to other stock exchanges like South Africa and Egypt. Therefore, to increase the number of listed companies there is need to ensure stable macroeconomic environment, encourage foreign multinational companies (MNCs) or their subsidiaries to be listed on the Nigerian Stock Exchange, relax the listing requirements to the first tier market and ensure tax rationalization in the capital market to encourage quotation and public interest in shareholdings. For new issues, increase the minimum equity capital requirements for companies other than banks, insurance companies and other financial institutions, encourage merger and consolidation, discriminatory income tax in favour of public quoted companies and aggressive enlightenment programme to increase awareness of the benefits of investing in the stock market and seeking quotation at the stock exchange. Lastly, to boost the value of transactions in the Nigerian capital market, there is need for availability of more investment instruments such as derivatives, convertibles, futures, swaps, options in the market

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Appendix 1: Gross domestic product and performance of the nigerian capital market from 1981-2008

Year	GDP at current prices (₦ B)	Total new issues (₦ M)	Market capitalization (Equities and debts) (₦ B)	Value of transactions (Government and industrial securities) (₦ M)	Total listing on the Nigerian Stock Exchange (Equity, industrial loan and govt. stock)
1981	205,222.1	455.2	4,997.8	332.1	194
1982	199,688.2	533.4	4,025.7	214.8	205
1983	185,598.1	448.5	5,768.0	397.9	212
1984	183,563	159.8	5,514.9	418.2	213
1985	201,036.3	817.2	6,670.7	319.6	220
1986	205,971.4	833.0	6,794.8	494.4	240
1987	204,806.5	450.7	8,297.6	348.0	244
1988	219,876.8	400.0	10,020.8	137.6	253
1989	263,729.6	1,629.9	12,848.6	521.6	267
1990	267,660	9,964.5	16,358.4	265.5	295
1991	265,379.1	1,870.0	23,125.0	136.0	239
1992	271,365.5	3,306.3	31,272.6	313.5	251
1993	274,833.3	2,636.9	47,436.1	402.3	272
1994	275,450.6	2,161.7	66,3680	569.7	276
1995	281,407.4	4,425.6	180,305.1	1,838.8	276
1996	293,745.4	5858.2	281,815.8	7,062.7	276
1997	302,022.5	10,875.7	281,887.2	11,072.7	264
1998	310,890.1	15,018.1	262,517.3	13,572.3	264
1999	312,183.5	12,038.5	300,041.1	14,027.4	268
2000	329,978.7	17,207.8	472,290.0	28,154.6	260
2001	356,994.3	37,198.8	662,561.3	57,6372	261
2002	433,203.5	61,284.0	764,975.8	60,088.6	258
2003	477,833	180,079.9	1,359,274.2	120,703.0	265
2004	527,576	195,418.4	2,112,549.6	225,820.6	277
2005	561,931.4	552,782	2,900,062.1	262,929.6	288
2006	595,821.6	707,400	5,120,000	470,253.0	294
2007	634,251	1,935,080	13,294,059	2,100,000	310
2008	674,889	1,509,230	9,562,970	4,400,000	301

Source: SEC, NSE, CBN (various issues)