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Full Length Research Paper

The capital market contributions towards economic growth and development; the Nigerian experience

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This study examined the impact the capital market has on the Nigerian economy, using time series data for 10-year period; 2000 – 2010. The model specification for the analysis of data is multiple regression and ordinary least squares estimation techniques. The gross domestic product was adopted as the dependent variable while the all-share index, market value and market capitalisation were the independent variables. The result showed that there are significant relationship between share index, market value and market capitalisation on GDP. This implies that the GDP is affected by the movement of the capital market's share index, market value and market capitalisation. In other words, the capital market has impacted significantly on the economy for the years under review.

Keywords: Capital Market, economy, analysis, Nigeria

INTRODUCTION

The growth and development of an economy, depends greatly on how the country's capital market thrives. The capital market can be an important facilitator of economic growth (Applegarth, 2004). Osaze (2000) is of the view that the capital market drives any economy to growth and development because the long term growth capital formation stems from it. Economic growth in a modern economy hinges on an efficient financial sector that pools domestic savings and mobilizes foreign capital for productive investments. (Bekaert and Harvey, 1997). Capital market offers access to a variety of financial instruments that enable economic agents to pool, price and exchange risk. Through assets with attractive yields, liquidity and risk characteristics, it encourages savings in financial form. This is very essential for government and other institutions in need of long-term funds and for suppliers of long-term funds. (Nwankwo, 1991). Based on its importance in accelerating economic growth and development, government of most nations tend to have keen interest in the performance of its capital market (Ewah, Esang and Bassey, 2009). The capital market has been identified as an institution that contributes to the socio-economic growth and development of emerging and developed economies. (Donwa and Odia, 2010). Generally speaking, the importance of the capital market to any economy (developed or emerging) cannot be swept under the carpet. A direct linkage has been discovered to exist between the capital market of a nation and its economic growth. Linkages were also found to exist between foreign direct investment (FDI), stability of capital market (which will indicate stability in the economy), sources of finance for economic development, investment avenue for surplus fund etc and the capital market. (Oladipupo, 2010).

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The concept of capital market

The capital market can be seen as any mechanism organized for trading financial assets or liabilities. Financial assets will include all forms of securities ranging from common stocks to derivatives.

The primary function of the capital market is to enable funds to be effectively allocated from the surplus units in the economy to the deficit units for productive investments. Indeed, with such mechanism, corporate financial managers have access to a wide range of sources of finance and instruments.

The Nigerian capital market provides the necessary lubricant that keeps turning the wheel of the economy. It is critical in the mobilization of savings to profitable self-liquidating investment. It not only provides the funds required for investments but also efficiently allocates these funds to projects of best returns to fund owners (Donwa and Odia, 2010).

Al-Faki (2006) defines the capital market as 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.

Nyong (1997) viewed the capital market as a complex institution characterized with inherent mechanism through which long term funds of the major sectors of the economy comprising households, firms and government are mobilized, harnessed and made available to various sectors of the economy.

Dada (2003) defined the capital market as an institution that exists to provide long term capital both to government and corporate bodies for industrial, socio-economic and infrastructural development purpose.

The Nigerian capital market

The Nigerian Capital market came into existence in 1960 under the nomenclature of Lagos Stock exchange and came to be known as the Nigerian Stock Exchange in December 1977. It began operations in 1961 with 19 securities listed for trading. Branches were opened in major cities of the country.

There are now thirteen branches of The Nigerian Stock Exchange excluding the head office in Lagos. Each branch has an electronic trading floor. The head office in Lagos was opened in 1961; Kaduna (1978), Port Harcourt (1980), Kano (1989), Onitsha (February 1990), Ibadan (August 1990), Abuja (October 1999), Yola (April 2002), Benin (January 2005), Uyo (2007), Ilorin (2008), Abeokuta (2008), Owerri (October 2009)and Bauchi (2009).

The NSE continues to evolve to meet the needs of its valued customers, and to achieve the highest level of competitiveness. With about 200 companies and 258 Securities listed, The Exchange operates fair, orderly and transparent markets that bring together the best of African enterprises and the local and global investor communities. The Nigerian Stock Exchange is poised to champion the acceleration of Africa's economic development and to become “the Gateway to African Markets” (Wikipedia).

Overview of empirical evidences

The linkage between stock market and economic growth has occupied a central position in the development literature (Osinubi, 1998). There have been growing concerns and controversies on the role of the stock market on economic growth and development. While some posits a positive link, others maintain a negative one and others still, does not find any evidence at all. These controversies only beg for more research and in-depth study on the matter.

Osinubi (1998) employed the neoclassical growth model with a time series data on all variables (ones he used) of GDP which was subjected to Augmented Dickey-Fuller unit Root Test and which spanned from 1980 to 2000 to come to the conclusion that a positive relationship exists between the economic growth and the measures of stock market development used. He however, pointed out that the relationships are statistically insignificant which goes further to show that the effect of stock market on economic growth is weak and insignificant.

In examining whether a strong empirical association exists between the stock market development and long-run economic growth, Levine and Zervos (1996) used pooled cross-country time series regression of forty-one countries from 1976 to 1993.

The growth rate of Gross Domestic Product per capita was regressed on a variety of variables designed to control for initial conditions, political stability, and investment in human capital and macroeconomic conditions. Conglomerated index of stock market development was also included. A strong correlation was discovered to exist which implied a positive relationship between stock market development and economic growth.

Okpara (2010) analysed the capital market performance and the growth of the Nigerian economy. A co-integration approach was used for the analysis of data. He used the real gross domestic product (as a proxy for development indicator) on the market capitalization, new issues, value of shares traded and turnover ratio as capital market indicators. It showed a long run relationship between the growth of GDP and the capital market indicators.

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 , which employed a time series data from 1970 to 1994, used four measures of capital market development; ratio of market capitalization to GDP (in %), ratio of total value of transaction on the main stock exchange to GDP (in %), the value of equities transactions relative to GDP and listing. These measures were combined into one overall composite index of capital market development using principle component analysis. A very negative and significant correlation between capital market development and the long run growth in Nigeria was posited as the result of this study.

In appraising the impact of the capital market efficiency on the economic growth of Nigeria, using a time series data from 1961 to 2004, Ewah et al (2009) found out that though the Nigerian capital market has the potential of growth inducing, there has not been any meaningful contribution to the economic growth of Nigeria. This, they said, was due to low market capitalization, low absorptive capitalization, illiquidity, misappropriation of funds etc.

Harris (1997) did not find hard evidence that stock market activity affects the level of economic growth.

The capital market and economic growth: theory

A number of economists have maintained that the capital market has little or nothing to offer to real economic activity (Stiglitz, 1989; Mayer, 1989; Harris and Raviv, 1991). Bekaert and Harvey (1997) have a different opinion. They outlined what an efficient capital market would mean for an economy and a country at large.

Ability to Diversify: Investors would have means to diversify their portfolios. Individuals can diversify firm-specific risks, thus making investment in firms more attractive. This is possible in an efficient market.

Change of Ownership: managers are disciplined indirectly through this means. Non-competent managers make stock prices to decline below the potential value of the assets. Efficiently, these managers are removed and replaced with one that can increase the value of the assets. Managers with productivity-decreasing actions are weeded out.

Innovation: An efficient capital market affects entrepreneurs in whole positive dimension. Entrepreneurs considers, not only profits generated in a new venture to the public. This provides long term productivity for the economy.

Applegarth (2004) highlighted areas where the capital market makes input as to developing and growing the economy;

Private Sector Development: The prospects for private sector growth in developing economies are being influenced by the access to and ease in movement of financial resources. Economic growth entails amongst other things, the extent at which existing firms can borrow and grow, the ability of emerging firms to act entrepreneurially, their willingness to invest in assets and the ability to allocate their assets freely.

Liquidity: liquidity has a proven relationship with economic growth. Liquidity is generated by the increase in the number of firms and investors participating in the market. Countries with liquid market experience faster rates of capital accumulation and greater productivity gains (Levin 1996). Firms are willing to make permanent investments critical to development since they are assured of being able to exit from longer-term investment. Local consumers are more willing to mobilize domestic savings. More resources are more efficiently distributed to the more productive and innovative firms since this process allows for a market based system of allocating financial resources.

Increase in Remittances: establishing mechanism for facilitating cost-effective transfer and savings of funds received through remittances – a rapidly emerging source of private capital in developing countries – can also contribute to economic growth. Remittances offer a promising and stable potential for increasing domestic savings and fostering domestic investment.

Corporate Governance: The creation of a legal and regulatory framework incorporating increased transparency and information dissemination is necessitated. Corporate governance is heightened, transparency improved and investors' confidence is boosted. Studies have shown a positive relationship between market based governance and improvements in industry efficiency. Industry efficiency promotes economic growth.

Donwa and Odia (2010) also enumerated roles the capital market play in the development of the economy;

- Creates avenues for marketing shares and other securities in order to raise fresh funds for expansion of operations leading to increase in output / production.
- The capital market aids the government in its privatization programme by offering her shares in the public enterprises to members of the public through the stock exchange.
- Foreign capital inflow is encouraged when foreign companies or investors invest in domestic securities.
- 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 aimed at providing essential amenities for socio-economic development.

Capital market and the real sector

Ovia (2008) earmarked the following subsectors of the economy to be under the real sector; Agriculture, Manufacturing, Mining, Quarrying and Real estate / construction

The real sector of the economy, is said to, in more ways than one, contribute uniquely and majorly to employment generation, poverty alleviation, FDI attraction, enhanced forex earnings and more rapid economic advancement.

In the bid to seriously finance the real sector of the Nigerian economy, various economic policies have been implemented by various administrations.

However, the capital market has remained a convenient and more affordable source of long term funding (Ovia, 2008). Ordinarily, the need for long term finance makes the capital market relevant to our development drive (Obademi and Adeyanju, 2010). In recent times, firms in Nigeria have actively utilized the NSE to raise funds for business expansion. In 2007, a third tier market was introduced by the NSE which in effect, has small and medium enterprises more opportunity to raise funds. Some real sector operators are already taking advantage of this opportunity.

Foreign direct investment

The mechanism through which FDI (Foreign Direct Investment) impacts on the economy is the capital market. FDI has become very crucial to both developed industrial and developing economies. FDI introduces foreign capital and skilled labour into an economy through the capital market. It also brings in technological know-how, raises efficiency and competitiveness, enhances export earnings and improves international marketing activities.

FDI is used as a control variable in the capital market since it is presumed that FDI is a determinant of economic growth (Agarwal and Mohtadi, 2004).

Consequently, host country governments ensure that enabling environment for foreign investment is created (Onu and Njiforti, 2010).

Nigeria has initiated economic reforms aimed at increasing the role of the private sector and creating an enabling environment for FDI. Negative effects, which FDI could impose on the country, as observed by Aremu (2003), are being minimized.

Foreign firms can raise the level of capital formation, promote exports and generate foreign exchange. They can provide the much needed market for domestic supplier and support industries and in the process, transfer technology, increase industrial linkages and stimulate industry as a whole while providing direct and indirect employment.

Bosworth and Collins (1999) in their study found that foreign direct investment raises a country’s rate of output growth by raising total factor productivity.

FDI has brought tremendous growth to the capital market and one of the evidences that an economy is growing is that the capital market is growing and till now, this is the Nigerian experience (Obademi and Adeyanju, 2010).

METHODOLOGY

Data

The study employed a time series data 10-year period 2000 – 2010 which were collated from the Central Bank of Nigeria statistical bulletin, Nigerian Stock Exchange publications etc. the data collected were capital market variables like Gross Domestic Products, Market Capitalization, All Share Index, Market Volume and Market Turnover.

Model Specifications

This study made use of multiple regression in estimating the relationship between indices of capital market operations and Nigerian economic growth. The Ordinary Least Square (OLS) technique was employed in obtaining the numerical estimates of the coefficients in the model formulated below.

Issues like economic growth in relation to capital market performance could be based on economic variables such as Gross Domestic Product (GDP) and capital market activities (Okpara, 2010). This stems from the fact that economic growth has been defined as the ability of the economy to increase production of goods and services produced in the economy. The GDP being the market value of goods and services produced in the economy over a period of one year should therefore have a link to the capital market activities.

Therefore, the multiple linear regression analysis was used with the GDP as the dependent variable which will be regressed against explanatory or independent variables like All Share Index, Market Value and Market Capitalization.

The model, this paper used for this purpose is stated as follows;

GDP = b0 + b1AS + b2MV + b3MT + Ui

where GDP = Gross Domestic Product, AS = All Share Index, MV = Market Value, MC = Market Capitalisation. U is the stochastic disturbance term and i the ith observation since the data is time serial.

RESULT

The summary of the regression result is shown in the tables.

The result shows that there are significant relationship between share index, market value and market capitalisation on GDP. This implies that the GDP is affected by the movement of the capital market’s share index, market value and market capitalisation. This means that the period under study; 2000 – 2010, the operations of the Nigerian capital market have had significant impact on the Nigerian economy

CONCLUSION

Based on the findings, this research work has yielded evidence that the capital market, in the years under review, has maintained a significant relationship on the GDP. In other words, the capital market operations have

Analysis Of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	6.13E+14	3	2.04E+14	9.537	.007[a]
	Residual	1.50E+14	7	2.14E+13		
	Total	**7.63E+14**	**10**			

Correlations

	GDP	SHARE INDEX	MARKET VALUE	MARKET CAPITALIZATION
GDP	1	r=0.702 (p=0.008; p<0.01; Test is Highly Significant)	r=0.806 (p=0.001; p<0.01; Test is Highly Significant)	r=0.871 (p=0.000; p<0.01; Test is Highly Significant).
SHARE INDEX		1	r=0.915 (p=0.000; p<0.01; Test is Highly Significant)	r=0.859 (p=0.000; p<0.01; Test is Highly Significant).
MARKET VALUE			1	r=0.859 (p=0.000; p<0.01; Test is Highly Significant)
MARKET CAPITALIZATION				1

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	1.04E+07	3.59E+06		2.907	0.023
	SHARE INDEX	-304.498	263.918	-0.499	-1.154	0.028
	MARKET VALUE	8.813	7.74	0.528	1.139	0.029
	MARKET CAPITALIZATION	1626.756	713.752	0.835	2.279	0.037

a. Dependent Variable: GDP

impacted greatly on the Nigerian economy.

The paper identified what an efficient capital market could mean for the economy.

However, this result differs from the findings of Osinubi (1998). He concluded that the effect of stock market on economic growth is weak and insignificant since the relationships are statistically insignificant. Harris (1997) has a different view as well. He did not find hard evidence that stock market activity affects the level of economic growth.

The findings also negates the conclusions of Ewah et al. (2009) who found out that the capital market in Nigeria has the potentials for growth inducing but has not contributed meaningfully to the economic growth of Nigeria.

RECOMMENDATIONS

In as much as it has been concluded that the capital market is responsible for the growth and development of the economy, steps should be taken in order to make it take full advantage of all its potentials in that regard;

- Foreign Investors should be encouraged to participate in the market in order to improve market capitalisation.
- The regulatory authorities should ensure transparency, fair trading transactions and dealings in the market so as to restore confidence.
- State of the art technology should be maintained.
- The reported cases of abuses and sharp practices in the market by some companies should be addressed.
- More investment instruments such as derivatives, convertibles, futures, swaps and options should be made available in the market in order to boost the value of transactions.
- New listings should be designed and deployed over the current plan horizon. This would be useful in dimensioning the outlook for the nation's capital market.
- Retail investor education/ awareness should be strengthened. Amongst other things, it will help to make investors know more on the long term nature of investments in the capital market, prevent them from

being defrauded.

- Capital market should offer investors ease of use and access.

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