Nigeria Capital Market and Its Impact On the Economy (1990 - 2013)

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Abstract

This paper examined the impact of capital market on economic growth of Nigeria between the periods of 1990 – 2013. The study adopted time series econometrics analysis to determine the long run and causal relationship between capital market and economic growth in Nigeria. The empirical analysis that was carried out to achieve the objectives mentioned above were diagnostic tests such as unit root, co-integration, Error Correction Mechanism (ECM) and ordinary least square (OLS), in which changes in GDP was regressed on Market capitalization (MCAP), All share index (ASI), Total value for Transactions (VLT) and Turnover (TO) using annual time series data from CBN statistical bulletin (volume 24). The result of our unit root showed that all variables are all stationary at first difference and also co-integrated of the same order in the long run. Similarly, the OLS result revealed that there is a significant impact of capital market on economic growth in Nigeria. Based on the findings above, the study recommends that there is the need for government to intensify effort in promoting investment in Nigeria. This can be done by creating an enabling environment for investment to thrive in the country The higher the number of investors in the economy the more the patronage received by the Nigeria stock exchange. Apart from improving the stock market development, investment will also increase domestic output which is a major antidote for any ailing economy.

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Introduction

Capital market is an engine of economic growth and development globally, the capital market is a highly specialized and organized financial market and indeed an essential agent of economic growth because of its ability to facilitate and mobilize saving and investment. The Nigerian capital market played an indispensable role in Nigeria's economy by providing funds for the investors without inconveniencing the companies. Today, the activities and performance of capital market in Nigeria have much wider implication and this arises partly because of the growing influence of ideas and structure associated with the concept of democracy.

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.

The Nigerian economy has over the years been subjected to series of social, political and economic policies and reforms. In the pre – 1970 era, the economy was basically agrarian and food security was largely achieved with the various regional governments then. The need to encourage private capital in development was realized long enough, with the establishment of the Nigerian Stock Exchange (NSE). NSE started in 1961 as a result of a recommendation of Barback committee announcement in 1958 to consider the ways and means of fostering the development of a Nigeria capital market. The Lagos exchange was registered on march 1st, 1958, incorporated on 5th June, 1981.it was transformed to industrial enterprises panel in 1976 and supported by the view of the committee on the Nigerian finance system.

The capital market effectively started operations in Nigeria on 5th June, 1961 under the provision of the Lagos Stock Exchange Act 1961, which transformed into the Nigerian Stock Exchange in December 1977 as a result of the review of the Nigerian financial system (CBN, 2007). The Securities and Exchange Commission (SEC) was established in 1979 through the SEC Act 1979, to regulate the capital market, but it commenced actual operation in 1980. It took over regulatory functions from Capital Issues Commission, which was established in 1973. Since then, various forms of financial instruments have been issued in the capital market by new and existing business to finance product development, new projects or general business expansion. The capital market, no doubt, is pivotal to the level of growth and development of the economy. Chinwuba and Amos (2011) note that capital market is one of the major institutions that acts in propelling a prostrate economy for growth and development. Nyong (1997), sees it as a complex institution imbued with inherent Mechanism through which long-term funds of the surplus sectors of the economy are mobilized, harnessed and made available to deficit sectors of the economy. Apart from this introductory section, the remaining part of this study is further divided into four other sections. Section 2 focuses on the review of both theoretical and empirical literature as section 3 sets the methodological framework for the study while section four focuses on the

estimations of model specified and section 5, being the last, concludes and proffer necessary policy suggestions.

Literature Review

Capital Market is a financial market that provides facilities for mobilizing and dealings in medium and long term funds. The players on the capital market are the operators who act as intermediaries between the providers of the funds and the fund users. They include, Securities Exchanges, Brokers/Dealers, Issuing Houses, Registrars and Investment Advisors. The capital market is a place (not physically limited) where people go and buy Securities such as shares, debentures and bonds. These Securities are interests in the issuing authority or company which give certain intangible rights to the purchaser in relation to dividend, interest payment and/or management of the company.

Various theories have been propounded by scholars in an attempt to explain the subject matter of capital market and economic growth. These theories are of great importance to this study as they serve as essential nucleus to this research study and as such the following below will be discussed in details

The new growth theory was developed in the 1980's as a response to criticism of the neoclassical growth model. The endogenous growth theory holds that policy measures can have an impact on the long run growth rate of an economy. For example, a subsidy on research and development or education increases the growth rate in some endogenous growth models by increasing the incentive to innovate.

The main implication of recent growth theory is that policies which embrace openness, competition, change and innovation will promote growth. Conversely, policies which have the effect of restricting or slowing change by projecting or favouring particular industries or firms are likely over time to slow growth to the disadvantage of the community.

Neoclassical Growth Theory of Solow

In the traditional neoclassical growth models developed by Solow (1956) and Mincer (1958) in the late 1950s, they showed that the output of an economy grows in response to larger inputs of capital and labour (all physical inputs). Non-economic variables such as human capital or human health variables have no function in these models. Furthermore, the economy under such a model conforms to the law of diminishing returns to scale. With these assumptions, the neoclassical growth models afford some implications to the economy; particularly, as the capital stock increases, growth of the economy slows down, and to keep the economy growing, it must capitalize from incessant infusions of technological progress. It is well known that this type of mechanism in the neoclassical growth model is neither inherent nor does it strive to explain much.

In economic lexicon, this simply means that the technological progress is "exogenous" to the system. Yet the reality is quite contrary to that, particularly for the developed economies, where the economies kept growing. This implies that it is not only technology which is the main driving force accountable for maintaining such high growth performance in these economies, but other factors which are outside the realm of neoclassical growth model.

In the mid-1980s, a new paradigm was developed in order to address some issues, Romer (1986, 1990) developed a model which is now commonly known as "endogenous growth models" by broadening the concept of capital to include human capital, the new endogenous growth model argues that the law of diminishing returns to scale phenomenon may not be true as is the case for developed economies. In simple terms, what this means is that if the firm which invests in capital also employs educated and skilled workers who are also healthy, then not only will the labour be productive but it will also be able to use the capital and

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technology more efficiently. This will lead to Hicks neutral‖ shift in the production function and thus there can be increasing rather than decreasing returns to investments.

In summary the conventional "neoclassical" growth theory as modelled by Robert Solow (1956) holds the view that economic growth is a result of the accumulation of physical capital and an expansion of the labour productivity. The exogeneity factor that increases productiveness has been questioned in the literature (e.g. Lucas, 1988; Romer, 1986; Azaridis and Brazen, 1990; Mankiw, 1992; UNDP, 1996). To them, what increases the productivity is not an exogenous factor, but an endogenous one, which is assumed to be related to the knowledge and behaviour of the people responsible for the accumulation of physical capital, thus human capital becomes part of the growth process.

Endogenous Growth Theory

The endogenous growth theory was made popular by Harrod Domar within the mid 1980`s , The AK model which is the simplest endogenous model gives a constant saving-rate of endogenous growth. It assumes a constant, exogenous saving rate. It models technological progress with a single parameter (A). it uses the assumption that the production function does not exhibits diminishing returns to scale to lead to endogenous growth. Various rationales for this assumption have been given such as positive spillovers from capital investment to the economy as a whole or improvements in technology leading to further improvements (i.e learning-by-doing).

However, the endogenous growth theory is further supporter with models in which agents optimally determined the consumption and saving, optimizing the resource allocation to research and development lending to technological progress. Romer (1987, 1990) anf significant contribution by Aghion and Howitt (1992) and Grossman and Helpman (1991) incorporated imperfect market markets and R&D to the growth model.

The Exogenous Growth Theory

The exogenous growth theory also known as the Solow Model, was developed by Solow (1956) and has been the major theoretical tool for economic growth until the 1980s. The theory holds the belief that economic growth arises due to influences outside the economy or company of interest. Exogenous growth assumes that economic prosperity is primarily determined by external rather than internal factors, according to this belief, given a fixed amount of labour and static technology, economic growth will cease at some point, as ongoing production reaches a state of equilibrium based on internal demand factors.

The concept of exogenous growth grew out of the neoclassical growth model and the works contributed by Solow (1956). The exogenous growth model factors in production, diminishing returns of capital and technological variable to determine economic growth.

From the empirical standpoints, Tokunbo (2006) examined if Stock Market Promote Economic Growth In Nigeria The stock market is a common feature of a modern economy and it is reputed to perform some necessary functions, which promote the growth and development of the economy. This study examines whether stock market promotes economic growth in Nigeria. To achieve this objective, ordinary least squares regression (OLS) was employed using the data from 1980 to 2000. The results indicated that there is a positive relationship between growth and all the stock market development variables used. With 99 percent R-squared and 98 percent adjusted R-squared, the result showed that economic growth in Nigeria is adequately explained by the model for the period between 1980 and 2000. By implications 98 percent of the variation in the growth of economic activities is explained by the independent variables. The results of the study, which established positive links between the stock market and economic growth, suggests the pursuit of policies geared towards rapid development of the stock market. Also, all sectors of the economy should act in

a collaborative manner such that the optimum benefits of linkages between stock market and economic growth can be realized in Nigeria.

Sunday (2008) conducted an appraisal of the impact of capital market efficiency on economic growth in Nigeria, using time series data on market capitalization, money supply, interest rate, total market transaction and government development stock that ranges between 1961 to 2004. The model specification for the analysis of data is multiple regression and ordinary lest squares estimation techniques. The result of the study shows that the capital market in Nigeria has the potentials of growth inducing, but it has not contributed meaningfully to the economic growth of Nigeria. This is as a result of low market capitalization, low absorptive capitalization, illiquidity, misappropriation of funds among others. The empirical test indicates that, these variables satisfied the economic apriori and are statistically significant except total transactions and money. Thus it was concluded and recommended that, the capital market remain one of the mainstream in every economy that has the power to influence economic growth, hence the organize private sector is encourage to invest in it. This will enable the capital market improve its illiquidity status for economic growth and development. Therefore, the government must contribute in order to achieve these objectives through investing government securities in productive sectors and relaxing laws that spell threat to the capital market.

Abel (2007) empirically verified and examined the nature of the relationship existing between stock market development and the level of investment flows in a country with a high degree of macroeconomic instability; and whether the stock market plays a uniform role in attracting both domestic and foreign investments in such economic situation. Extrapolated macroeconomic quarterly data (over a period from 1970 to 2006) are used in the analysis. The Johansen Co integration model is adopted to examine the long-run trends in the variables. While controlling for other variables, a vector error correction model (VECM) is used in estimating the relationship between investment growth, on one hand, and stock market development on the other. The study shows that development in the Nigerian stock market over the years was able to spur growth in domestic private investment flows, but unable to do so in the case of foreign private investment; and that development in the country's banking system rather had some destabilizing effects on the flow of private investments. The researchers attributed this to persistent cases of distress and failure in the banking system. This study is among the few of its kind to have empirically sort for and established some discriminate effects of stock market development in the flow of domestic and foreign private investments, at least from the point of view of a constrained market economy.

Ologunde et al (2008) examined the relationships between stock market capitalization rate and interest rate. Time series data obtained from Central Bank of Nigeria (CBN) and Nigeria Stock Exchange (NSE) were analyzed using regression. Results showed that the prevailing interest rate exerts positive influence on stock market capitalization rate. Government development stock rate exerts negative influence on stock market capitalization rate and prevailing interest rate exerts negative influence on government development stock rate. The study further revealed information as very important to capital market development. It was therefore recommended that the operators of the Nigeria capital market should raise the level of awareness so that investors will be abreast with the happenings in the market.

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Methodology

For this paper, causal comparative or ex post Facto Research Design fits perfectly. This is because the study attempts to explore cause nature that affects relationships, where causes already exist and cannot be manipulated. The study intends to use what already exist and look backwards to explain why. In every research work, there is every need to examine the specification of procedures. These procedures involve decisions on what information to generate, the data collection method, the measurement approach and the way in which the data are to be analyzed with respect to the master plan for executing the research work, effort are made to proffer solutions to the issue of external debt financing and economic growth of Nigeria.

However, due to conventional reasons, the researcher will use E-view statistical package with the help of computer for a reliable result

Model Specification

The model tries to examine the relationship between capital market and its impact on the economic growth of Nigeria between 1990 to 2013. RGDP which is the dependent variable was measured as a function of independent variables which are MCAP, ASI, VLT, and TO. This statement is written in functional form as;

GDP= f (MCAP, ASI, VLT, TO) ---------------------------------- (1)

The equation can further be written in linear form as

Where; GDP = Gross Domestic Product (proxy for economic growth)

MCAP = Market Capitalization

ASI = All share index

VLT = Total value for Transactions

TO= Turnover

The explicit form of equation (i) above is represented as:

$GDP = \beta_0 + \beta_1 MCAP + \beta_2 ASI + \beta_3 VLT + \beta_4 TO + u$ ……………… (2)

Where: β_0 = intercept of relationship in the model

$\beta_1 - \beta_4$ = Coefficients of each of the model.

U= the error term.

By log linearising, the model becomes;

$\log(GDP) = \beta_0 + \beta_1 \log(MCAP) + \beta_2 \log(ASI) + \beta_3 \log(VLT) + \beta_4 \log(TO) + u$ ……….……..(4) Where;

Log = Natural log From equation (3) model can be specified in a time series forms as;

Presentation and Analysis of Results

Having estimated the model, the variables considered are gross domestic product (dependent variable), Market capitalization (MCAP), All share index (ASI), Total value for Transactions (VLT) and Turnover (TO) were all used as the independent variables. The result covers the period of year 1990 – 2013.

Data collected for this study were subjected to Unit root, Cointegration, Regression. The results and their discussion are here presented.

Unit Root
Table 1 below shows the results from Augmented Dickey- Fuller (ADF) with Trend and Intercept

Test	Variables	Levels		First Differences		Order of Integration
		t- statistic	Critical	t- statistic	Critical	
ADF	RGDP	0.157176	-3.622033	-4.281704	-3.632896	I(1)
	MCAP	-1.093982	-3.622033	-4.086507	-3.673616	I(1)
	ASI	-3.080938	-3.622033	-5.028117	-3.644963	I(1)
	VTL	-3.800270	-3.622033	-4.643633	-3.632896	I(0)
	TO	-4.945529	-3.622033	-3.846771	-3.658446	I(0)

Note: * Implies significance at 5%
Source: Author's Computation using view 7.0

From the unit root test conducted above it was observed that two variables out of the five employed were stationary at level i.e (VTL and TO) given that their ADF test statistics was found greater than the critical value at 5% level of significance, However, all the variables considered as RGDP, MCAP, ASI VTL and TO, became stationary after first difference since their ADF test statistics were greater than their critical values at the same level of significance. Therefore, the variables are fit to be used for the analytical purpose for which they were gathered.

Cointegration test
Table 2 showing the Johns an contegration results
Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.987213	187.7184	69.81889	0.0000
At most 1 *	0.893340	91.81262	47.85613	0.0000
At most 2 *	0.752666	42.57430	29.79707	0.0010
At most 3	0.255492	11.83997	15.49471	0.1648
At most 4 *	0.215845	5.349280	3.841466	0.0207

Trace test indicates 3 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.987213	95.90579	33.87687	0.0000
At most 1 *	0.893340	49.23832	27.58434	0.0000
At most 2 *	0.752666	30.73432	21.13162	0.0017
At most 3	0.255492	6.490692	14.26460	0.5511
At most 4 *	0.215845	5.349280	3.841466	0.0207

Max-eigenvalue test indicates 3 cointegrating eqn(s) at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

Under the Johansen Co-Integration Test, there are two co-integrating equations. In Johansen's Method, the trace statistic determines whether co-integrated variables exist. As can be seen from the trace statistics, their values; the first and second third and Fourth race statistics all conforms to the decision rule in the two equations in other words; the null hypothesis of no co-integration among the variables is rejected since at least one variable in equations at 5% was statistically significant. The test result shows the existence of a long-run equilibrium relationship among the variables

Regression result

Dependent Variable: LRGDP

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.974638	1.181869	4.209127	0.0005
LMCAP	0.882144	0.138768	6.356965	0.0000
LVLT	-0.243551	0.095245	-2.557107	0.0193
LASI	0.009110	0.238947	0.038126	0.9700
LTO	0.321528	0.235566	1.364917	0.1882

R-squared	0.970906
Adjusted R-squared	0.964781
F-statistic	158.5149
Prob(F-statistic)	0.000000
Durbin-Watson	1.136410

Source: Author's Computation using view 7.0

From the regression result presented above, the constant term has a coefficient of 4.974634 implying that at when all independent variables are kept constant, Gross domestic product (GDP) will be equal 4.97 billion naira. The coefficient of Market capitalization (MCAP) is

0.882144 this entails that a unit increase in MCAP will bring about a 0.8-billion-naira increase in gross domestic product of Nigeria. The coefficient of All share index (ASI) is 0.009140 indication a unit increase in GDP by 91 billion naira. In like manner the coefficient of Total value for Transactions (VTL) is -0.243551 indicating a negative relationship with GDP that is to say a unit decrease in VTL will be followed by an inverse relationship to GDP by 24 billion naira.

Furthermore, the coefficient of Turnover ratio is 0.321528 this entails a unit increase in TO will bring about increase in GDP by 32 billion naira.

The result further shows that the R square is about 0.97. This is an indication that about 97% variation in economic growth proxied with gdp is explained by the independent variables that is market capitalization (mcap), turnover ratio(to), all share index (ASI) and value of transaction(VLT). The value of F statistics is 158.51. The value is also statistically significant at 5% level. This shows that the model is statistically significant and we can conclude that capital market indicators have positive significant impact on the growth of the Nigerian economy.

Implication of the Study

Findings from the study have revealed that market capitalization is the only stock market variable that show significant and positive impact on the growth of Nigeria. This conforms to the findings of Hamid (2006) and Mohamed (2007). These studies in their separate findings on Pakistan and Arab economies discovered a positive and significant relationship between market capitalization and economic growth.

However, result from the study have also revealed that All share index used in the study that is the stock traded all share index failed to have significant positive impact on the economic growth. The stock traded all share index has been shown to be a better stock market indicator than market capitalization Somoye (2000). The implication of this is that capital market development in Nigeria still appears not to be contributing enough to the economic growth of the country. Sunday (2008) and Abel (2007) also in separate studies on the Nigerian economy posited that the Nigerian stock market has not contributed the expected quota to the growth of Nigeria. It appears that our result from this analysis is also in support of this because they are based on the Nigerian economy. Finally, the Turnover is was found to have a significant relationship with the growth of Nigeria. Hence the level of turnover can influence more investor in the capital market.

Conclusion

Findings from the study have shown that market capitalization has a significant and positive impact on the economic growth of Nigeria. This is an indication that as market capitalization improves in the stock market in Nigeria the higher the economic growth of the country. However, the stock traded turnover ratio which has been described as a better indicator of the growth of the capital market failed to have any significant impact on the growth of the Nigerian economy. The implication of this is that the gains from the capital market have not been adequately felt by the Nigerian economy despite it significant as shown. Therefore, it can be concluded that the stock exchange in Nigeria is still fall short of the expected impact it should have on the growth of the Nigeria economy. In addition, the stunted growth of the Nigerian stock market has been further revealed by the weakness of the stock turnover ratio in determining the level of economic growth of Nigeria.

Policy Recommendations

In considering the findings from the research work the following recommendations are made

A. The capital market have the tendency to finance the entire infrastructural needs and gaps if the government can employ fiscal incentives to deepen the market by encouraging the companies in the trading and working sectors of the economy such as Power, housing and estate aviation oil and gas and the manufacturing sector to listed on the securities market of the Nigeria stock exchange market.

B. The capital market should be given a faced lifted through organized polices and strengthen it regulatory and monitoring bleeds so as to improve more the level of service.

C. The Nigeria capital market should move toward gearing international recognition and acceptance as this will enhance her operation world over.

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