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The Role of Capital Markets in the Development of Nigerian Economy

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1.0 INTRODUCTION

Mobilization of resources for national development has long been the central focus of development economist. As a result of this, the centrality of saving and investment in economic growth has been given considerable attention. For sustainable growth and development, fund must be effectively mobilized and located to enable business and the economy harnessed their optimal output. The financial market enables governments and industry to raise long term capital for financing new project, expanding and modernizing industrial commercial concerns. If capital resources are not provided to those economic areas, especially industries where demand is growing and which are capable of increasing production and productivity, the rate of the expansion of the economy often suffers. A unique benefit of both the money and capital market to corporate entities is the provision of equity securities and provision of long term, non-debt financial capital. Through the issue of equity securities, companies acquire perpetual capital for development. With the provision of equity capital, the market also enables companies to avoid over reliance on debt financing, the improving corporate debt to equity ratio.

According to Samuel (1996), Dam and Leume (1996), developed economics had explore the two channels through which resources mobilization affects economic growth and development (Money and Capital Markets). But, this is however not the case in developing economies where emphasis was placed on money market with little consideration for capital market.

Alile (1996) states that since the introduction of Structural Adjustment Programme (SAP) in Nigeria, the country's capital market has grown very significantly. This is as a result of deregulation on the financial sector and the privatization exercises, which exposed investors and companies to the significance of the capital market. Equity financing according to Othereke (2004) is one of the cheapest and flexible sources of financing from the capital market and remain a critical element in the sustainable development of the economy. Though the financial market is growing, it is however characterized by complexities. The complexities arise from trends in globalization and increase variety of new instrument brings traded equity options, derivatives of various forms, index futures etc. However, the central objective of the financial systems worldwide remains the maintenance of the efficient market with attainable benefit of economic growth (Alile, 1997). The link between stock market performance and economic growth has often generated strong controversy among analysts based on their study of developed and emerging markets.

According to Nylon (1999), the financial structure of a firm, that is the debt and equity financing changes as economies develop. As economies develop, more fund are needed to meet the rapid expansion. The financial market, that is, the money and capital market serves as a veritable tool in the mobilization and allocation of saving among competing uses which are critical to the growth and efficiency of the economy (Alile, 1984). These functions serve the purpose of channeling funds lenders to borrowers. They hold money balance or borrow from individuals and other institutions in order to make loans available for other investments. In order words, they act as financial intermediaries for those who presently are short of fund and therefore need temporary financial accommodation.

The below average growth performance of several less developed countries (LDCs) have development. Consequently, a wide ranging set of reform have been implemented with the aim to liberate depressed growth inducing factors. Prominent among these set of reform is financial sector reform. It is argued that financial liberalization is the ingredient needed to promote growth.. thus, the need to understand the direction of the relationship between finance and growth is undoubtedly necessary. One view is that growth induces expansion of the financial sector. That is economic growth provides the means for the formation of growth. Promoting financial intermediaries in turns accelerate growth by enhancing the allocation of capital. The financial sector mobilizes and channel resources from savers to investors and thereby causing real growth. For instance, insufficient financial development has sometimes created a poverty trap and thus became a serve hindrance to growth even when a country has established other conditions for sustainable economic growth.

The focus of this empirical work is therefore decidedly broadened to investigating the strength of the link between capital market and long run economic development.

There have been a number of policies and programme enunciated to develop the Nigerian capital market. This study therefore tends to find out the impact of capital market in the development of the Nigerian economy.

2.0 LITERATURE REVIEW

Economists have long debated the nature and empirical importance of the relationship between financial system and economic growth. Begehot (1973) and Hick (1969) argue that financial system plays a crucial role in igniting industrialization in England by facilitating the mobilization of capital for viable projects. To Begehot, "any undertaking likely to pay and seems to be likely can perish for want of money" thus, by effectively mobilizing resources for project, the financial system plays a crucial role in permitting the adoption of better technology and thereby encourage growth. Hick (1969) postulates that, the products manufactured during the first decades of the industrial revolution had been invented much earlier.

Goldsmith (196), gauge financial development by using the value of financial intermediary assets to divide lag gross national product (GNP) under the assumption that the size of the financial system is positively correlated with provision and quality of the financial services. This he did using data for thirty five countries from 1869 to 1963. He discovered that;

1. A rough parallelism can be observed between economic and financial development if periods of several decades are considered.

2. There are indications in the few countries for which the data are available that, periods of more rapid economic growth have been accompanied though not without exception, by an above average of financial development.

Smith concludes that financial development accelerate economic growth and improves economic performance to the extent of facilitating the migration of funds to the best users. That is to place in the economy where the fund will yield the highest social returns. In line with Gold Smith argument is that of Patrick (1966). He observed that financial development is capable of including real sector growth gets under way. That is, as the process of real occurs, the supply leads impetus gradually to diminish to import, while the demand following financial response assume more importance. Robinson (1952) declares that "where enterprise leads, finance follows". Ceteris paribus, economic development creates demands for particular types of financial arrangement to these demands. That is, demand leads financial system growth and that banks passively respond to economic growth. Some economists do not believe that financial growth relationship is important. Lucas (1988) asserts that economists badly over stress the role of financial sector in economic growth, whole development economist frequently express their skepticism about it. But, advancement of empirical findings would convince most skeptics to the believe that the development of financial markets and institution is a critical and inextricable part of the growth process.

According to Oni (1998), stock market reflects the true picture of the economy. Thus, in a market economy, stock market valuation matters for investment. For instance, Fisher and Merton (1984) states that, if the aim of a manager is to maximize the wealth of existing shareholders, they should monitor and respond to market valuation even when this deviates from the true value of the firm. The role of the stock market is to value the firm as well as provide finance. The stock market transmits information about the firm prospects to potential investor and creditors. Empirically, King and Levine (1993) shows that the level of financial intermediation is a good predictor of long run rates of economic goods, capital accumulation and productivity improvements.

Historically, focus has been on the banking sub sector. They are seen as providing another avenue for borrowers and lenders to meet (Levine and Zevous 1996). It is observed that in countries that witnessed the rise of securities market, a division of labour in finance crystallized with banks dealing relatively in short term loans and securities providing long term fund. Specifically, countries with larger banks and more active stock market grows faster over subsequent decades even after controlling other factors underlying economic growth. Levine (1999), explores functional approach to explain the role of financial system in economic growth. This approach highlights the importance of examining the relationship between financial structure and the provision of financial service. He examined two channels through which each financial function affects economic growth; capital accumulation and technical innovation. On these channels different classes of growth model were employed. On the capital accumulation model, the financial model, the financial system affects it by altering the saving rates, reallocating savings among different producing technologies. In the technical model, the financial system affects it by altering the rate of technological innovation. It follows therefore that since the financial system bears some correlation which the economic growth, the various component of this system should contribute significantly to economic growth.

Anyanwu (2004) examines whether there is a strong empirical association between Nigeria stock market development and long term economic growth. His findings corroborate the inclusion of other authors. He found that Nigeria stock market development is positively and strongly correlated with long run economic growth even after controlling other factors linked with economic growth. Bowden (1999), highlighted on the association between capital market and economic growth. From the optimum growth approach, we can see that savings is absolutely essential for economic growth provides opportunities for everybody to get more things and not to have work extra hard. Savings must be invested to bring about economic growth and investment translates savings into growth. When people save money, they leave some of the current output un-bought. The left over output is then bought by businessmen and used to increase future production.

The capital market

The capital market is a market for the mobilization and utilization of long term funds for development (Anyanwu, 1999). It is a market for long term instrument. In a capitalist society like Nigeria, the existence of such financial market can greatly ease the process of exchanging loan able funds for financial claims. The instrument traded in the market includes: government securities, corporate bonds and shares (stocks) and Mortgage loans. The market is for channeling funds for development.

According to Philip (1985), it is a mechanism whereby economic unit desirous to invest their surplus income internet with those businesses. For instance, a firm that wants to borrow money can to the market with the assurance that those with funds to lend will be there. The market consists of an inner capital (market for new securities) and the outer capital market (market for new securities) and the outer capital market (not directly involved with the issue of new securities but engaged in the business of long term borrowing and lending upon which the issues of new securities depends). The capital market embraces both the primary market and secondary market. In Nigeria, the participant of security market include Nigerian stock exchange, discount houses, development banks, investment banks, building societies, stock broking firms, insurance and pension organization, quoted companies, government, individuals and the Nigerian securities and exchange commission (NSEC).

A further distinction needs to be made between these types of financial market. As noted earlier, new issues of loanable funds are traded in the primary market. Transaction in this market results in either the creation or the extinction of financial claims. The creation of new loan causes the transfer of cash from a lender to a borrower in exchange for a financial claim. Secondary market on the other hand is a market for old issues. Transaction here does not create or extinguish financial claims. Thus, the economic function of the secondary market is to support the operations of the primary market by providing liquidity to lenders. Without this market, an individual saver might be unwilling to lend money profitable for investment for a long period of time. This is because, to lend is to forego liquidity. To realize long term lending, it is important to provide the means by which lender can quickly and inexpensively restore liquidity without calling in their loans.

Anyanwu (1997), states that the existing issues of secondary market in a strict sense constitute the stock exchange since it is the mechanism which gives liquidity to the securities listed on the exchange. Capital market in which trading in secondary issues is rather thin, exist in many countries including Nigeria. In most less developed countries, the volume of trading that makes it possible to regard long term financial assets as liquid is because they can be sold quickly without significant market loss. This possibility are said to have breath in when orders to but and sell comes from many different groups. When new orders come into the market in volumes with price fluctuation, market with this characteristic provides liquidity for assets than otherwise. Investors are induced to hold these assets because risk is minimized and borrowers easily obtain funds.

Evolution of the Nigerian capital market

The origin of the Nigeria capital market can be traced to the period of the colonial masters, who at that time sought for fund to run the local administration. It became necessary to set up the basic infrastructure as well as the development of an organized private sector for the establishment of a smooth financial system. The first step in this regard according to Odife (2000) was to secure the necessary finance for the development of this infrastructure and long term capital projects. In 1946, he went ahead to promulgate a 10 year plan local ordinance to float the first N300,000 3% government stock 1963/61 with its management vested on the Accountant General. In 1951, the colonial administration also enacted a law in order to create loan funds for the financing of public utilities. The colonial government also set up the Professor Barback Committee to examine the ways and means of fostering a share market in Nigeria. Part of the agenda of this committee included the possibility of establishing a capital market in Nigeria. In 1958, the central bank of Nigeria was established following the central bank Act of that same year. These various legislations were aimed at establishing the infrastructural and legal framework for the take-off of viable securities/capital market in Nigeria. As a follow up to these laws, the colonial administration issued the first N2m federation of Nigeria development loan stock in May 1959.

In 1960, the central bank of Nigeria issued the first Nigeria Treasury Bills which were meant to provide an opportunity for the investment of short term liquid funds and to assist in the provision of government funds while waiting for a re-imbursement as its receipt revenue. Also the Lagos stock exchange was incorporated as a private limited company and members were given the monopoly power to deal in securities granted quotation on the exchange following the Lagos stock exchange Act of 1960, in 1961, the Lagos stock exchange opened for business with 19 listed securities made up of 3 equities, 6 federal government bonds and 10 industrial loans. In 1962, the capital issues committee was constituted to examine and recommend the establishment of an apex monitoring institution for the growing of the Nigerian capital market. Also in 1972, the capital issues committee was enacted to act as the apex regulatory institution for the Nigerian capital market. Following the degree, it was empowered to ascertain the price and timing of new issues of securities through offer for subscription. While in 1977, the name Lagos Stock exchange was changed to the Nigerian stock exchange by the 1977 indigenization decree as recommended by the industrial enterprises panel of 1975 that branch exchange should be established. By this, six trading floors of the Nigeria stock exchange were created in Port Harcourt, Onitsha, Kaduna, Yola, Kano and Ibadan. In 1978, the Securities and Exchange Commission decree was enacted to replace the capital issues commission and to expand the scope of their operations as recommended by the financial system review committee (Okigbo Committee, 1976).

Functions of the Nigerian capital market

a. Mobilizes savings from surplus economic units for channeling into deficit units for the purpose of industrial and economic development. By carrying out these functions, the capital market plays an important role in promoting a nation's socio-economic development.

b. Ensures through its allocative mechanism, an efficient and effective distribution of scare financial resources for optimal benefit to the economy, in form of increases productive activities, more employment opportunities, and general improvement of the well being of the populace.

c. Create an avenue for the populace to participate in the corporate sector of the economy and share in its wealth, through ownership of securities.

d. Reduce the over reliance of the corporate sector on short term financing for long term projects.

e. Provide seed money for venture capital development which could serve as a vehicle for industrial development.

Roles of the capital market in economic growth

a. It provides opportunities for companies to borrow funds needed for long term investment purposes.

b. Provide avenue for the marketing of shares and other securities in order to raise fresh funds for expansion of operations, leading to increase in output and productivity.

c. Provide facilities and enable foreign businesses to offer their shares to the Nigerian market.

d. Encourages inflow of foreign capital companies or investors invest in domestic securities.

e. Provides opportunities for government to financial projects and aimed at providing essential amenities for socio economic development.

Empirical studies on the impact of stock market on economic growth

Levine and Zervos (1976), examined whether there is a strong empirical association between stock market development and long run economic growth. To evaluate this association, this study pooled cross country time series regression of forty one countries from 1976 to 1993. The growth rate of Gross Domestic product (GDP) per capita is regressed on a variety of variables designed to control for initial conditions, political stability, investment in human capital and macro conditions, and this include conglomerated index of stock market development. The findings were that a strong correlation between overall stock market development and long run economic growth exist. This means that the result is consistent with the theories that imply a positive relationship between stock development and economic growth. Efforts were also made by Nyong (1997) to develop an aggregate index of capital growth. The nature and economic significance of the relationship between stock market development and growth vary according to a country's level of economic development (Filler Hanousek and Campus, 2000).

The proponents of positive relationship between stock market development and economic growth hinged their argument on the fact that the stock market aids economic growth and development through risk diversification, liquidity creating ability and corporate governance improvement among others. Nyang (1997) reported that as far back as 1969, Goldsmith Raymond observed that the emergence of equity market and its development indicate the level of economic growth and development. Using the liquidity argument, Benovenga, Smith and Star (1996) reasoned that the level of economic activities is affected by the stock market through its liquidity creating ability. The leak of this reasoning term capital commitment; often investors are not willing or, are reluctant to trade their savings for a long gestation period. With liquidity equity market, risks associated with investment are reduced, making it more attractive in investors. Thus, the easy transfer of capital ownership facilities firm's permanent access to capital rose through equity issue. Therefore, as liquid market improves the allocation of capital, the prospect for long term economic growth is enhanced. Also, savings and investment are increased due to the reduction of the risks of investment facilitated by stock market liquidity.

However, an alternative view on stock market and long term economic growth by Demingue-Kunt and Levine (1996) observed that there are some channels through which liquidity can later grow. First, savings rate may be reduced. This happens when there is increasing returns on investment through income and substitution effect. As savings rate falls with the existence of externality attached to capital accumulation, greater stock market liquidity could slow down economic growth. In addition, the reduction of uncertainties associated with investment may have impact on savings rate, but the extent and the direction remain ambiguous. This is because it is a function of the degree of risk over senses of economic agents. Effective corporate governance often touted as an advantage of liquidity of stock market may be adversely affected. Market development was to determine its relationship with long run economic growth in Nigeria. The study employed a time series data from 1970 to 1994. For measures of capital market development, the ratio of market capitalization on GDP (in percentage), the ratio of total value of transaction relative to GDP and listings were used. The four measures were combined into one overall composite index of capital market development using principal component analysis. A measure of financial market depth (that is the ratio of broad money to stock of money to GDP) was also included as control. The result was that capital market development is negatively and significantly correlated with long run growth in Nigeria. The result also shows that there exist bi-directional causality between capital market development and economic growth.

3.0 METHODOLOGY

Research methodology refers to the method, modalities or procedures by which this study is to achieve its objectives. It involves the appraisal of the operational framework and research designs of the study. The problem of this research study relates to the contribution of the capital market to the growth of the Nigerian economy. The study addresses the planning of scientific inquiry, designing a strategy for finding out something.

Model specification

In view of the theoretical framework, a model which can capture the contribution of the capital market growth of Nigeria economy for 27 years from 1980-2007 will be formulated. The role of the stock market is a function of the extent of usage and its relationship with other sectors of the economy. The expression can be written as follows:

GDP = f (MCAP, RROI, NLS, CIT, VNI)

Where:

GDP = Gross Domestic Product

MCAPT = Market capitalization

RROI = Rate of returns on investment

NLS = Number of listed securities

CIT = Corporate income tax

VNI = Value of new issues

$GDP = a_0 + a_1MCAP + a_2RROI + a_3NLS + a_4CLT + a_5VNI + Ui$

Method of data analysis

The model will be estimated using ordinary least technique (OLS) and will show that contribution of capital market to the growth of the Nigerian economy from 1980-2007. This study will adopt basically the technique of multiple linear regressions, the coefficient of determination of R^2, the standard error test t, as well as the f-test to determine the extent to which the independent variable affects the dependent variable. The regression estimate will be carried out and the result at 5 percent level of significance.

4.0 PRESENTATION OF REGRESSION AND ANALYSIS

GDP = 5186149 – 4.7980MCAP – 692112.8RROI + 1861.938NLS + 262.6671CIT
t = (1.300344) (2.624158) (3.171488) (0.088345) (4.072342)
R^2 = 0.49163, F = 3.674478, DW = 2.129066

The above regression result shows that the value of R^2 (coefficient of determination is 0.491603). this implies that about 49% of the systematic variation in GDP is jointly explained by MCAP, RROI, NLS and CIT. this low percentage of explanation shows that there is no goodness of fit in the regression line. F-test conducted shows that f-observed (3.674478) is greater than f-critical (2.06) at 5% level of significance. This shows that there is overall statistical significance in the linear relationship exist between the dependent variable and independent variable. T-test for MCAP shows that t-observed (2.624158) > t-critical (2.06) at 5% level of significance with two-tailed test. This shows that MCAP is statistically significant in explaining GDP.

The sign of the coefficient of MCAP is negative, which means that as MCAP increases, GDP reduces. T-test for RROI shows that t-observed (3.171488) > t-critical (2.06) at 5% level of significance with two tailed test. This means that RROI is statistically significant in explaining GDP. The sign of the coefficient of RROI is negative; this means that unit rise in RROI will bring about reduction in GDP. T-test for NLS shows that t-observed (0.088345) < t-critical (2.06) at 5% level of significance with two-tailed test.

This shows that NLS is positive, meaning that a rise in the value of NLS will lead to increase in GDP and for the t-test for CIT shows that t-observed (4.072342) > t-critical (2.06) at 5% level of significance with two tailed test. This means that CIT is statistically significant in explaining GDP. The sign of the coefficient of CIT leads to increase in GDP. The Durbin Watson Statistic is 2.129066, this shows that a negative autocorrelation exist in the specified model.

From the interpretation of the regression result, the f-test conducted which shows that there is overall significance of the independent variable in explaining the dependent variable (GDP). Therefore, Hi (the alternative hypothesis) is accepted showing that the Nigerian capital market has positively influenced economic growth in Nigeria within the study period.

The research work has examined the contribution of capital market to the growth of Nigerian economy. Particularly, the result found out that capital market plays an important role in the growth, expansion as well as the development of the Nigerian economy. There is need for the government and relevant agencies to formulate and implement appropriate policies that will create an enabling environment for the expansion of the capital market since the research has shown that it is very important indicator to the growth of the economy.

According to Kuzents in his noble lecture defined economic growth as “a long term rise in capacity goods to its population, this growing capacity based on advancing technology and the institutional and ideological adjustment that it demands”.

5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

Summary

During the period of 27 years under review, the Nigeria capital market has achieved moderate growth to the economy. The government enacted several laws and degree to enable the market sound footing. The various legislatures covered the broad areas of income tax, market regulation, commercial banking, etc.

Also the issue of private sector involvement was very vital to the study, since conventionally, the capital market is a capitalist institution designed for the purpose of providing long term capital. The objective of our study was to ascertain whether the existence of the Nigerian capital market has contributed to Nigerian economic growth. This involves us testing various economic variables such as the value of company income tax against the growth of Gross Domestic Product (GDP) from the period 1980-2007 was found out that the value of company income tax has a positive effect/impact on the growth of the nation’s Gross Domestic Product and the value of company income tax in the Nigeria stock exchange is able to explain the variations in GDP.

Conclusion

With the establishment of the Nigerian stock exchange in the 60’s and its recent and subsequent opening, the country should expect a more significant investment capital inflow and thus economic growth. There is therefore no gain saying that the already identified policy shifts by the government are welcome development as they have boosted domestic investors confidence in the ability of our markets to respond (through appropriate pricing) to changes in the economic environment. This no doubt observable in the performance of the Nigerian economic growth as it’s particularly identified in the GDP.

Recommendation

Stock market all over the world facilitates investment and capital formation which form the bedrock of economic growth and development. Bearing in mind, the crucial difficulties facing the Nigeria capital market and recognizing the roles of the federal government, the apex regulating and self regulatory institutions as well as intermediary in the development of the market, the market, the following policy recommendations are made:

i. The federal government, SEC and NSE having influenced much of the activities of the market so far is also in the strongest position to revitalize the market for the sole purpose of economic growth and should take the following steps;

ii. Formulate a clear cut political economic policy and reduce significantly government in the operations of the market which distort the shares valuation, pricing and allotment mechanism.

iii. Set up a committee to evaluate the whole basis for establishing a capital market in the country and determine to what extent such a programme is justified with respect to the country's basic economic growth.

iv. Effort must be made to internationalize the Nigerian stock market to attract more foreign investment.

v. The Nigerian stock exchange should embark on the cost of structuring quota securities on the exchange affordable, but maintain high standard and integrity in the market.

vi. Maintain fair securities prices for the market.

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