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Empirical Analysis of the Impact of Capital Market Efficiency on Economic Growth and Development in Nigeria

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Abstract

This study examines the impact of Nigerian capital market on economic growth and development between 1999 and 2012. Data were collected from Security Exchange Commission reports, Nigerian Stock Exchange Review Reports, and Central Bank of Nigeria Statistical Bulletin respectively. Ordinary lease square method of regression analysis was used to analyze the data. The result shows that capital market indices have not significantly impacted on the GDP. It was concluded that 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, and misappropriation of funds among others. The study recommends that government should restore confidence to the market through regulatory authorities which will portray transparency, fair trading transactions and dealing in the stock exchange, improve dealing in the market capitalization by encouraging more foreign investors to participate in the market and also to increase investments instruments such as derivatives, convertibles, swap and option in the market.

Keywords: Capital market, GDP, Shares, Growth, Nigeria.

Introduction

The importance of capital market as an efficient channel of financial intermediation has been recognized by the researchers, academicians, and policy makers as a primary determinant of the economic growth of a country globally. Previous studies (Kolapo and Adaramola, 2012; Odetayo and Sajuyigbe, 2012; Afees and Kazeem, 2011; chiwuba and Amos, 2011; Petru-Ovdiu, 2010; Osamwonyi, 2005 and Agarwal, 2001) agree with the view that efficient financial intermediation is crucial to economic development and positively influences growth and development.

The Nigerian capital market has continued to play its traditional role of mobilizing medium to long-term funds for development purposes. The Securities and Exchange Commission (SEC) is the regulatory authority of the market and the operational institutions are the Nigerian Stock Exchange, the issuing houses and the stock broking firms. The capital market consists of the primary market for new issues of securities and the secondary market for trading in existing securities. So far, trading floors exist at Kaduna, Kano, Port Harcourt, Onitsha, lbadan and Abuja. Activities in both markets have increased tremendously over the years. The activities of capital market have been boosted by the privatization programme (Sunday, Ewah and Jude, 2009). Pagano, (1993) identifies three fundamental channels through which capital markets and economic growth may be linked: First, capital market development increases the proportion of savings that is funneled to investments; Second, capital market development may change the savings rate and hence, affect investments; Third, capital market development increases the efficiency of capital allocation.
The capital market has undergone tremendous reforms in recent years. Among these is the introduction of Central Securities Clearing System (CSCS), an automated clearing, settlement and delivery system aimed at easing transactions and fostering investors' confidence in the market. Equally important is the linking of performance information on the Nigerian Stock Exchange to Reuters International System in order to disseminate relevant market information to subscribers. However, poorly functioning capital markets typically are illiquid and expensive which deters foreign investors. Illiquid and high transactions costs also hinder the capital raising efforts of lager domestic enterprises and may push them to foreign markets.

Literature Review
Capital market is market where securities are traded. Osamwonyi, (2005) sees capital market as an exchange system set up to deal in long-term credit instrument of high quality. The dealing in this high quality instrument facilitates the execution of some desirable and profitable project bearing direct relationship with economic development. Nwankwo, (1999) agrees that capital market offers 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 saving in financial form. 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. Ewah, et al (2009) is of opinion that capital markets provide the opportunities for the purchase and sale of existing securities among investors thereby encouraging the populace to invest in securities and fostering economic growth. Levine and Zervos (1998) posit that the level of financial intermediation is a good predictor of economic growth. Chiwuba and Amos, (2011) contend that capital market can affect economic development through the mobilization of long-term resources, the provision of liquidity, risk diversification, privatization, securitization or risk transfers and determination of the cost of capital for project valuation. Odetayo and Sajuyigbe, (2012) also agree that capital market is an engine of economic growth and development, in the same view Ariyo and Adelegan (2005) believe that the liberalization of capital market contributes to the growth of the Nigeria capital market, yet its impact at the macro-economy is quite negligible.

Functions of Capital Market
Sunday, Ewah and Jude (2009) identify the following functions:

1) To provide facilities to the public in Nigeria for the purchase and sale of funds, stocks and shares of any kind and for the investment of money.
2) To regulate the dealings of members interest and those of their clients.
3) To control the granting of a quotation on the stock exchange in respect of funds, stocks and shares or any company, government, municipality local authority or other corporate bodies.
4) To promote, support, or propose legislative or other measures affecting the aforementioned objectives.
5)Provide trading facilities for dealing in securities listed on it.
6) Oversee activities relating to trading in securities.
7) Enhance the flow of long-term capital into productive investment and ensuring fairness of prices at which quoted securities are traded.

Ekineh, (1996) says that an efficient capital market reduces the transaction costs of trading the ownership of the physical assets and thereby paves the way for the emergence of an optimal ownership structure. Thus, efficient and liquid capital markets provide avenues for the effective utilization of funds for long-term investment purposes by mobilizing them from the surplus spending economic units to the deficit spending economic units. Therefore, efficiently functioning capital market affects liquidity, acquisition of information about firms, risk diversification, savings mobilization and corporate control (Anyanwu 1998).

Challenges of Nigerian Capital Market

Olisaemeka (2009) identifies some challenges of Nigerian capital market as following:

1. A Global Phenomenon: The present seeming collapse of the world economy has not excused that of Nigeria. Many stock markets of countries, from USA to Britain, from China to Japan, Russia, France and others are in serious trouble. The world is indeed a global village and the interrelatedness of world economies is very evident that any development in any part of the world affects other parts as well. Consequently, the Nigerian capital market is not insulated from this global malignant cancer.

2. Pull-Out of Various Foreign Investors: This is another factor believed to have contributed to the continuous fall of the Nigerian stock market. Many foreign investors that already have troubles in their home economies have pulled out of the Nigerian stock market leading to dumping of shares beyond the ability of domestic investors to contain. Supply of equities has, in consequence of this, overwhelmed demand, leading to price fall.

3. Lack of Infrastructure and High Production Costs: The cost of doing business is high in Nigeria. Basic infrastructures like good roads, power supply are lacking, leading to high cost of doing business. Many quoted and unquoted companies like Dunlop Nigeria Plc and Michelin Nigeria have closed down shops. Most of the textile industries have also stopped production, leading to the crash of their share prices. The shares of Dunlop Nigeria Plc that sold above ₦6 per share a few months ago now trade below N0.6 per share. Evidently, high production costs reduce profitability or increase loses which also impact negatively on the share prices.

4. Impact of Commercial Banks: Following the forced capitalization of banks to a minimum of N25billion, almost all banks utilized and accessed the capital market to raise funds. Within two years plus, many of the banks besieged the capital market more than once, falling over one another in raising funds through mega offers in a single tranche. The banks competed to suck every liquidity from the Nigerian financial system, thus overheating it. Through enticing marketing strategies, the banks succeeded in their various offers, but left the capital market

place bleeding and gasping for breath. The primary market seemed to experience a boom while the secondary market was sucked dry as many investors dumped their shares in the secondary market, in favour of the primary market offers achieved through bewitching marketing efforts of banks.

5. Avalanche of Private Placement Offers: A number of private companies did private placement of their shares at lower prices while they sought or intended to seek quotation of their shares at higher values on the Nigerian Stock Exchange, thus making such private placements very attractive. This lured investors to dispose or dump their shares in the secondary market, purchase the private placements and dispose of same immediately after their listing on the Stock Exchange at higher prices. The Nigerian capital market thus became a battleground as private companies were falling on each other through avalanche of offers. The regulating bodies were impotent as the Investment and Securities Act, 2007, does not place private companies under their control.

6. Inability of the Federal Government to Plot a Bailout Option: There were blunt statements from the Federal Government that it will not intervene directly in the capital market which it sees as a purely private affair. The government lacked the wisdom to examine the socio-economic implications and chain effects of a failed capital market.

7. Regulating Inconsistencies and Pronouncements: The apex regulator of the Nigerian stock market, the Securities and Exchange Commission, prior to the crash of the market had alleged publicly that stock market prices were being manipulated and it announced that it was probing some quoted companies.. This contributed to the crash of the market. Unfortunately till date, not much has been heard of the outcome of the SEC investigation that transmitted shockwaves down the spines of investors.

8. Pressure from Banks: Following the more than ₦1 trillion of banks' funds tapped in the capital market, the banks have become violent on the borrowers of funds (investors and stock broking firms) used to acquire shares. Currently these banks have brought suicidal pressure to bear on these borrowers, compelling them to sell their shares at any price, just to have a moment of respite. This has further increased the supply of shares at ridiculous prices, leading to greater market crash.

Empirical Studies on the Relationship Between Capital Market and Economic growth

The results of previous Studies on the relationship between capital market and economic growth are mixed. For instance, Odetayo and Sajuyigbe, (2012) examine the impact of Nigerian capital market on economic growth and development during the period 1990 – 2011 using ordinary least square regression. The authors discover that capital market indices have significant impact on the economic growth. In the same view, Kolapo and Adaramola, (2012) find that Nigerian capital market development has significant relationship with economic growth. Afees and Kazeem (2010) also, critically and empirically examine the causal linkage between stock market and economic growth in Nigeria between 1970 and 2004 and the result shows that capital market development drives economic growth. Mishra, et al (2010) examine the impact of capital market efficiency on economic growth of India using the time series data on market capitalization, total market turnover and stock price index over the period spanning from the first quarter of 1991 to the first quarter of 2010. Their study reveals that there is a linkage between capital market efficiency and economic growth in India. This linkage is established through high rate of market capitalization and total market turnover. The large size of capital market as measured by greater market capitalization is positively correlated with the ability to mobilize capital and diversify risk on an economy wide basis. The increasing trend of market capitalization in India would certainly bring capital market efficiency and thereby contribute to the economic growth of the country.

Osinubi and Amaghionyeodiwe (2003) also examine the relationship between Nigeria stock market and economic growth during the period 1980-2000 using ordinary least squares regression (OLS). The result showed that there is a positive relationship between the stock market development and economic growth and suggest the pursuit of policies geared towards rapid development of the stock market. Uwubanmwen (2001) and Ilaboya and Ibrahim (2004) investigated the impact of stock market performance on the growth of economic activities in Nigeria by relating stock market performance indicators to Gross Domestic Product and 'the results obtained were generally satisfactory.' Bolbol, Fatheldin, and Omran (2005) also analyze the effect of financial markets on total factor productivity and growth in Egypt between 1974 and 2002 it was discovered that capital market development had a positive influence on factor productivity and growth.

However, Flavia and Petru, (2010) discover that capital markets hasn't reached a level of development that would enable it to fulfill its main function in the economy, the gap with the countries of Europe being still quite high. Harris (1997) did not find hard evidence that stock market activity affects the level of economic growth. And also Osinubi and Amaghionyeodiwe (2003) examine the relationship between the Nigerian stock market and economic growth during the period 1980- 2000. Their findings did not support the claim that stock market development promotes economic growth and these results are in line with Ewah et al; (2009) finding, who appraise the impact of the capital market efficiency on economic growth of Nigeria using time series data from 1963 to 2004. They find 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. Therefore, it is hypothesized that:

Hypothesis 1: Nigerian capital market has no significant impact on economic growth and development of Nigeria.

Methodology

The data were obtained mainly from secondary sources particularly from Central Bank of Nigeria Statistical Bulletin, Nigeria Stock Exchange Fact books, annual reports and statement of accounts (Various Years) of quoted companies and other relevant publications. The data collected are for a period of fourteen years, from 1999 to 2012. Specifically, the data collected are market capitalization (MCAP) of the NSE, value of transactions (VTS) on the NSE, number of listed Companies (NLS) on the NSE, and Gross Domestic Product (GDP) for the relevant years. The procedure for analyzing the data was through econometric procedure. The technique used was the multiple regression analysis to test whether the capital indices have impacted positively on the economic growth of Nigeria denoted by gross domestic product (GDP).

The model used in the study is GDP= f(MCAP, VTS ,NLS) and can be specified as follows:

$GDP = \beta_0 + \beta_1 MCAP + \beta_2 VTS + \beta_3 NLS + \mu$

μ = disturbance term

β = intercept

$\beta_1 - \beta_3$ = coefficient of the independent variables

Table 1
Gross Domestic Product And Performance Of Nigerian Capital Market From 1999 -2012

YEAR	GDP	MCAP	VTS	NLS
1999	312183	300042	14027.4	268
2000	329978.7	472290	28154.6	260
2001	356994.3	662561.3	576372	261
2002	433203.5	764975	60088	258
2003	477833	135927.2	120703	265
2004	527576	2112549.6	225820.6	277
2005	561931.4	2900062	262929	288
2006	595821.6	5120000	470253	294
2007	634251	13294059	1076020.4	310
2008	674889	9562970	1679143.7	301
2009	716949.7	7030800	68572000	266
2010	801700	9920000	79755000	264
2011	901300	10280000	63492000	250
2012	1067650	89000000	62758000	198

SOURCE: SEC, NSE, CBN (statistical bulletin)

Data Analysis

Table 2
Multiple Regression Analysis Table Showing Market Capital, Value Of Transactions, And Total Number of Listed Equity And Government Prediction Of Gross Domestic Product (GDP).

Variables	LgMCAP	LgVTS	LgNLS	-Con
Coefficient	**-0.04601**	**0.061244**	**-8855.394**	**3132425**
Std, err,	**0.02455**	**0.025495**	**24780.26**	**6922883**
T	**-1.87**	**2.40**	**-0.36**	**0.45**
Probability	**Pns**	**P<.05**	**Pns**	**Pns**
P = 0.1380 (ns) **R^2 = 0.4096** **Adj. R^2 = 0.2324** **F = 2.31**				

Interpretation of Result

It can be deduced from table 1 that predictor variables (i.e market capitalization, value of transactions and total number of listed companies) jointly predict gross domestic product but insignificant with (R^2 = 0.4096; F(3, 10) = 2.31; Pns). The predictor variables jointly explained 40.96% variance of GDP, while the remaining 59.04% could be due to effect of extraneous variables. Furthermore, value transaction (VTS) (β = 0.06; t = 2.4; P <.05) is significantly independent predictor of gross domestic product (GDP). This implies that an increase in value of share transaction will lead to an increase in GDP by 0.06 units. However, market capitalization (MCAP) (β = -0.04; t = -1.87; P ns) and number of listed companies (NLS) (β =-88; t = -0.36; Pns) were not independently significant predictors of GDP. This implies that market capitalization and number of listed companies have not made any significant impact on the economic growth and they have negative relationship with GDP in the long run. This result is in line with Osinubi and Amaghionyeodiwe (2003) and Ewah et al; (2009) who discover that 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.

However, result of this paper is contrary to the findings of Kolapo and Adaramola, (2012); Odetayo and Sajuyigbe, (2012); Afees and Kazeem, (2011); Chiwuba and Amos, (2011); Petru-Ovdiu, (2010); Osamwonyi, (2005) and Agarwal, (2001) who agree that Nigerian capital market has significant impact on economic growth and development. Therefore, the hypothesis is partially accepted.

This finding of this research work may be as a result of loss of confidence in the Nigeria economy, as many investors prefer to convert their naira to foreign currencies, especially the dollar and hold them through their domiciliary accounts, inability of stock broking firms to settle their clients for securities sold and loss of confidence in the regulatory bodies.

Conclusion and Recommendations

This study examines the impact of Nigerian capital market on economic growth. To achieve this, a model was formulated which reveals stock market performance indicators to Gross Domestic Product. The result shows that market capitalization, value of stocks and total listed companies jointly predict economic growth but insignificant. The study conforms to the positions of Osinubi and Amaghionyeodiwe (2003) and Ewah et al; (2009) that 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, and misappropriation of funds among others.

Based on the above conclusion, it is therefore recommended that government should restore confidence to the market through regulatory authorities which will portray transparency, fair trading transactions and dealing in the stock exchange, improve dealing in the market capitalization by encouraging more foreign investors to participate in the market and also to increase investments instruments such as derivatives, convertibles, swap and option in the market.

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