

# Assessment of Financial Restructuring and Capital Market on Economic Growth In Nigeria

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## Abstract

The study empirically examines the assessment of financial restructuring and capital market on economic growth in Nigeria. In line with the objectives of this study, secondary data were obtained from central bank of Nigeria statistical bulletin covering the period of 1980 to 2009. Multiple regressions were employed to analyze data on such variables as Asset of Deposit Money, Financial structure, Lending- Rate, Market capital and Real Gross Domestic Product (RGDP), interest rate, inflation, and exchange rate were all found to have significant effects on the economics growth with the adjusted  $R^2$  of 85 %.The outcome of this study suggests that capital market impact on economic growth via market capitalization, financial restructuring, meaning that they are potent variables that are capable of influencing economic growth

It is recommended that in order to improve market capitalization, foreign investors should be encouraged to partake in the capital market. Also, responsible government agency should be called to restore confidence to the capital market through ensuring transparency and fair trading transaction and dealing in the stock exchange.

**Keywords:** Financial Restructuring, Capital Market, Lending- Rate, Economic Growth

## Introduction

One of the oldest debates in economics has remained the relationship between financial development and economic growth (Ujunwa and Salami 2010). The capital market is viewed as a complex institution imbued 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 (Nyong, 1997).The capital market instruments become mature for the period above one year. Capital

market is an institutional arrangement to borrow and lend money for a longer period of time and it is an avenue for long term investment. It is also a market for financial assets which have a long or indefinite maturity (Guarav 2010).

According to Greenwood and Smith (1996), capital markets lower the cost of mobilizing savings, facilitating investments into the most productive technologies. Obstfeld (1994) shows that international risk sharing through internationally integrated capital markets globally improves resource allocation and accelerates growth. Bencivenga, et. al. (1996) and Levine (1991) have argued that capital market liquidity has the ability to trade equity easily and plays a key role in economic growth.

It could be argued that a well-developed stock markets tying managers' compensation to stocks is an incentive compatible design that aligns the interests of principles (owners) and agents (managers), thereby spurring efficient resource allocation and economic growth. Although profitable investments require long run commitment to capital, savers prefer not to relinquish control of their savings for long periods. Liquid equity markets ease this tension by providing assets to savers that are easily liquidated at any time, while simultaneously allowing firms permanent access to capital that are raised through equity issues. Liquidity has also been argued to increase investor incentive to acquire information on firms and improve corporate governance (Kyle, 1984; Holmstrom and Tirole, 1993), thereby facilitating growth. The capital market enables governments and industry to raise long-term capital for financing new projects, and 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 expansion of the economy often suffers. A unique benefit of the stock market to corporate entities is the provision of long-term, non-debt financial capital. Through the issuance of equity securities, companies acquire perpetual capital for development. Through the provision of equity capital, the market also enables companies to avoid overreliance on debt financing, thus improving corporate debt-to-equity ratio (Ohiomu S. and Godfrey O. E. 2011). Capital market is the market for capital funds. The word "capital", used in this context, infers a long-term commitment on the part of the lender(s) and a long-term need for the funds on the part of the borrower (Luckett 1976). It encompasses any transaction involving long-term debt or equity obligations. Capital market can ideally be subdivided into the primary market and the secondary market. The primary market deals with the selling of new securities when they are first issued by the issuing corporation. Since many of the initial buyers of these securities will eventually want to resell them, there is also a secondary market for "second-hand" or previously issued, securities. The stock market, for example is a secondary market in corporate securities. Evolution of stock market has impact on the operation of banking institutions and hence, on economic promotion. According to him this means that stock market is becoming more crucial, especially in a number of emerging markets and their role should not be ignored (Kahn M, Sendahji A, 2000). Levine and Zervos brought out that a well-established stock market not only can mobilize capital and diversify risks between market agents but also it is able to provide different types of financial services than banking sector to stimulate economic growth.

The institution that dominates the primary market is the investment banking house. When a corporation decides that it wants to acquire new funds from the outside, it will frequently do so through the intermediation of an investment banker (Luckett, 1976).

### **Statement of the problem**

The general beliefs preceding the market crisis was that Nigerian banking systems relied on tacit government approval of large loans (to sectors, if not to individual firms), and it was understood that the major banks would not be allowed to fail. Under these circumstances, credit analysis and risk management were largely redundant and, considering the functioning of courts, even documenting loans and liens was pointless. These weaknesses reinforced each other. The motivation to upgrade bank supervision was undermined by the powerful political connections of the major banks. The enforcement of single borrower or connected lending limits and consolidated bank supervision was also problematic because of the web of enterprises, banks and non-bank financial institutions controlled by the conglomerates.

Lacking effective legal protection, non-controlling shareholders were routinely exploited. Outsiders therefore preferred to fund firms through debt (with a specified stream of payments) rather than through equity (which requires closer monitoring of firms). This tendency toward high corporate leverage was compounded by the controlling owners' reluctance to cede control or disclose much about the firm. The inadequacy of courts in enforcing creditor contracts contributed to a shortening of loan maturities, with each lender believing it would be possible to refuse to rollover the loan if problems arose.

Due to the fact that Nigeria was badly affected by the global economic meltdown of 2008 actually created an unprecedented apathy towards stock and the inability of Nigeria policy makers to adequately address those stock exchange market apathy. By this attitude of the government, lack of understanding of the relationship between capital market and economic growth once again spurred the focus of this paper.

### **Objective of the Study**

The objective of this research study is to evaluate and determine the structural relationships that exist between capital market and economic growth in Nigeria from 1980-2009. This is planned to be achieved with the following specific objectives:

- i. To assess financial restructuring, capital market and economic growth in Nigeria.
- ii. To investigate the direction of relationship that exist between financial restructuring and economic growth in Nigeria.
- iii. To examine the impact of capital market on real growth in Nigerian.

### **Literature Review**

#### **Financial Restructuring and Capital Market on Economic Growth in Nigeria**

By early 2005 large segments of the financial and corporate sectors in Nigeria were severely distressed or insolvent. Equity and currency markets had collapsed, private credit lines had been cut and output had declined sharply. The political dimensions of the subsequent restructuring – involving conflicts over the recognition and allocation of losses among shareholders, creditors, managers, workers and taxpayers – added to the complexity of the resolution effort. The government advocated mergers rather than the closure of any financial institution or sale to foreign institutions, and tightly orchestrated Nigeria's financial sector restructuring program. In light of the level of stress and existing political and economic trends, the number of banks is expected to continue to shrink, particularly through mergers. Some of the stronger banks are likely to make strategic alliances with foreign partners, and the banks under the control of the Central bank of Nigeria (CBN) are expected to be sold to strategic

investors. As public resources for further recapitalisation are limited, additional forbearance on capital adequacy regulations may continue to be needed.

According to Louis, Kupukile, Victor and Tianshu (2009) an important element of Nigeria's financial reform relates to the payment system and the interbank money market. Payment system reforms were also put in place when seven banks were appointed as settlement banks for the clearing of checks. Between 2006 and 2007, the value and volume of clearing checks grew from 14.9 million to 19.9 million and 16.4 million to 28.1 million, respectively, reflecting the shift from noncash transactions to the use of checks by individuals. To encourage the use of checks, writers of dishonored checks were subject to fines and prosecution, and these penalties would be enforced. The introduction of the Central Bank of Nigeria (CBN) interbank fund transfer system for transferring funds among banks increased the value of transactions by 56 percent. The nonpayment of interest on standing deposit facility also instilled confidence and encouraged banks to place and borrow funds between themselves and discount houses.

The country's financial reforms also saw an increase in the number of mergers and acquisitions, involving 89 banks. This resulted in 25—and then 24, after one bank was taken over—stronger, bigger banks. Some banks acquired other financial institutions such as stockbrokerages in order to offer wholesale or universal banking products. The emergence of strong, large banks has created a lot of healthy rivalry and competition, as financial institutions compete to attract more customers by offering attractive deposit rates and loan rates. Nigerian banks have invested in research and development to ensure that their level of services is up to an international standard, with more focus on personal banking. To assist the banks that were raising new funds from the capital market to reduce the cost of those funds and ensure a seamless transition, regulatory authorities gave them concessions. The empirical evidence we have presented in this chapter shows that the reforms in Nigeria have engendered more competitiveness in the financial services sector. Overall, banks have been strengthened by the reforms and are now exploring new opportunities in markets beyond Nigeria into other parts of Africa. Raising the domestic banking market to international standards, where domestic banks have transparent corporate governance to enable them compete favorably with any new foreign banks in the market, is a policy objective that many African countries should emulate, especially in view of the current global financial crisis (Louis K. et al 2009).

According to Alile 1984, 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. 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). Arango(2002) found that some evidences of the non-linear and inverse relationship between share prices on the Bogota stock market and LR as measured by the international bank loan which is to some extent affected by monetary policy. Zordan(2005) said that historical evidence illustrates the stock price and the lending rate to be inversely correlated .Uddin and Allam (2007) examine a linear relationship between share price and changes in lending rate. It was found in all studies that lending rate has a significant relationship with the changes of share prices. It gradually changed from a significantly

negative to no relationship or even a positive although insignificant relationship when Jefferis and Okeahalam (2000) worked on south Africa, Botswana and Zimbabwe stock market, where increase LR are hypothesized to depress stock prices through the substitution effect (international bearing asset becomes more attractive relative to shares). An increase in discount rate (and hence a decrease in present value of future expected returns), or a depressing effect on investment and hence an expected future profit. Relationship between lending rate and stock market is fairly indirect because they tend to move in the opposite direction that is decrease in lending rate means that people who want to borrow money enjoys an interest rate cut but those who are lending or buying securities such as bonds have a decrease opportunity to make income from interest. If we assume investors are rational, a decrease in lending rate will prompt investors to move money away from bond market to equity market and at the same time business will enjoy the ability to finance expansion at a cheaper rate thereby increasing their future earnings potential which in turn leads to higher stock price. Investors and economic view of lending rates decreases as catalyst for expansion overall, the unified effect of lending rate cut is the psychological effect it has on investors and consumers, they see it as benefit to personal and corporate borrowing which in turn leads to greater profit and an expansion. Interest rates are generally as low as they can possibly go and we all expect them to move upward from here.

Government programs for financial and corporate sector restructuring have had three important consequences: namely that market confidence has been restored, that governments have become large holders of corporate assets and that large public sector debt has built up. Essentially, substantial portions of corporate assets have been brought under government control and this has been financed by government borrowing. Strengthening regulatory and supervisory frameworks for banking systems, improving corporate governance and developing capital markets.

### **Data and Methodology**

This section addresses issues such as addressed include; research design, study population sample and sampling technique, data collection and research instrument validation.

#### **Method of data collection**

Method employed in Carrying out this research work was by secondary data. Secondary data were gotten from CBN Statistical Bulletin.

#### **Sample size**

The duration of my research was basically from 1980-2009 which is in the range of 30yrs. This study employs annual data on the rate of non export, inflation, exchange rate and economic growth (proxy by Gross domestic products) for Nigeria over the period 1980 to 2009. Data were obtained from the CBN Statistical Bulletin.

### **Results**

The results presented below are based on the data collected from CBN Statistical bulletin. The data collected is used to establish assessment of financial restructuring and capital market on economic growth in Nigeria. The analysis was done using the stata 10 to enhance the accuracy and robustness of the regression results. The unit root test of stationary and the result of the analysis are presented below:

Regression models in the following variables:

The unknown parameters denoted as  $\mu$ : this may be a scalar or a vector.

The independent variable Y

The dependent variable R

In various fields of application, different terminologies are used in place of dependent and independent variables

A regression model relates  $R$  to a function of  $Y$  and  $\mu$

$$R = p(Y_1, Y_2, Y_3, \mu)$$

Where  $Y_1 - Y_3$  are the independent variables.

### Model specifications

Two different models will be adopted for this research work. The first model measured economic performance employing the real gross domestic product (RGDP) as the explained variable, while market capitalization (MK) was used to depict the level of stock market performance measured by the ability of investors to raise funds from the market. Financial structure (FS) variable measured by ratio of total asset of all deposit money bank to GDP was employed as a control variable to x-ray the soundness of the Nigerian financial system and the lending rate (LR) was used to determine the rate at which financial institutions lend money that is base from which banks lend money to the final customer. The second model used real GDP as explained variable while the explanatory variables are; market turnover, degree of openness, minimum discounted rate, exchange rate and TS (transaction at the stock rate).

The models are stated as follow;

$$\ln RG = \alpha_0 + \alpha_1 MK + \alpha_2 FS + \alpha_3 LR + \mu \quad (1)$$

$$\ln GDP = \alpha_0 + \alpha_1 MT + \alpha_2 DOP + \alpha_3 MRR + \alpha_4 ER + \alpha_5 TS + \mu \quad (2)$$

Where:

GDP	=	Gross Domestic Product
RG	=	All Manufacturing Goods in the Country within the specific years.
MK	=	Market capitalisation.
FS	=	Financial Structure
LR	=	Lending Rate
MT	=	Market turnover.
DOP	=	Degree of openness of the economy
MRR	=	Minimum rediscounted rate.
ER	=	Exchange rate.
TS	=	Transaction at the stock rate.
$\mu$	=	Error or disturbance term.



**Unit roots test**

Null Hypothesis: LENDING\_RATE has a unit root

Exogenous: Constant

Lag Length: 0 (Automatic - based on SIC, maxlag=7)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-2.079886	0.2537
Test critical values: 1% level	-3.679322	
5% level	-2.967767	
10% level	-2.622989	

\*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(LENDING\_RATE)

Method: Least Squares

Sample (adjusted): 1981- 2009

Included observations: 29 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LENDING RATE	-0.221120	0.106314	-2.079886	0.0472
	4.172603	1.985794	2.101227	0.0451
R-squared	0.138094	Mean dependent var	0.240276	
Adjusted R-squared	0.106172	S.D. dependent var	3.459301	
S.E. of regression	3.270510	Akaike info criterion	5.274241	
Sum squared resid	288.7983	Schwarz criterion	5.368537	
Log likelihood	-74.47649	Hannan-Quinn criter.	5.303773	
F-statistic	4.325926	Durbin-Watson stat	2.107467	
Prob(F-statistic)	0.047157			

Interestingly, it can be observed that on application of the ADF test on the level series only lending rate was not stationary (that is it contain a unit root) as indicated by the fact that its respective critical value is larger (in absolute terms) than the calculated ADF statistics, thus the null hypothesis of the presence of a unit root could be rejected as it is integrated by the fact that its respective critical value is larger (in absolute terms) than the calculated ADF statistics, thus the null hypothesis of the presence of a unit root could be rejected as it is integrated of the order one. The remaining variables, RGDP, MKTCAP, Asset of deposit money bank and financial structure were stationary at their levels. The null hypothesis of the presence of unit root in the series was rejected as indicated by the values of their calculated ADF (in absolute terms) statistics which were higher than their critical values. In this direction, we say that their series are integrated of the order zero that is  $1(0)$  consequently, the ADF test was applied on the log of the differenced series (lending rate) to make them stationary, except RGDP, MKTCAP, ASDMB, and FINSTRCUT which had been originally stationary at their levels.

Based on the foregoing, it became necessary to test for cointegration. By using the log-level form of the series, a multivariate cointegration relationship was estimated to establish the existence of a long-run equilibrium.

Table 2:

*Co-Integration Test on The Assessment of Financial Restructuring and Capital Market on Economic Growth In Nigeria*

Johanson’s maximum likelihood cointegration test

Series: ASSET\_OF\_DEPOSIT\_MONEY\_B FINANCIAL\_STRUCTURE LENDING\_RATE MKTCAP  
RGDP

Lags interval (in first differences): 1 to 1

Unrestricted Cointegration Rank Test (Trace)

Hypothesized	Trace	0.05		
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None	0.651854	57.30665	69.81889	0.3273
At most 1	0.472028	29.87319	47.85613	0.7254
At most 2	0.307701	13.26670	29.79707	0.8790
At most 3	0.132805	3.705529	15.49471	0.9258
At most 4	2.94E-05	0.000764	3.841466	0.9788

Trace test indicates no cointegration 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	Max-Eigen	0.05		
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None	0.651854	27.43346	33.87687	0.2409
At most 1	0.472028	16.60649	27.58434	0.6138
At most 2	0.307701	9.561171	21.13162	0.7847
At most 3	0.132805	3.704765	14.26460	0.8891
At most 4	2.94E-05	0.000764	3.841466	0.9788

Max-eigenvalue test indicates no cointegration at the 0.05 level

\* denotes rejection of the hypothesis at the 0.05 level

\*\*MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegrating Coefficients (normalized by b'S11\*b=I):



ASSET OF DEPOSIT MONEY	FINANCIAL STRUCTURE	LENDING RATE	MKTCAP	RGDP
2.43E-07	-0.208505	-0.158634	-0.003599	1.26E-05
2.58E-07	0.093838	-0.062370	0.000924	-7.79E-06
3.97E-08	-0.512551	-0.387849	-0.004400	2.21E-05
-1.87E-08	0.069637	-0.133811	0.000879	-3.03E-06
-1.23E-07	-0.033194	-0.003491	-0.004574	2.59E-07

Unrestricted Adjustment Coefficients (alpha):

ASSET OF DEPOSIT MONEY	-1889112.	-2513501.	-1053907.	-913448.8	444.8880
FINANCIAL STRUCTURE	-9.652341	6.496420	1.889243	-1.794342	0.027254
LENDING RATE	-0.366065	-0.072008	0.995163	1.029752	-0.001680
MKTCAP	9.846789	97.69389	-172.3587	76.98359	-0.465331
RGDP	-220134.0	147397.7	44788.91	-39679.35	685.4001

Table 2 shows the summary result of the Johanson's maximum likelihood cointegration test. The test relations were estimated with intercept and linear deterministic trend in a Vector Auto regression (VAR) model of order one (1) with a lag length of one (1), which was found to be most parsimonious for the data series. The Johansen cointegration test is based on the Maximum Eigenvalue of the stochastic matrix as well as the trace of the stochastic matrix. From the result it is evident that both the trace test and the maximum eigenvalue test indicate one cointegrating equation as the null hypothesis of  $r = 0$  is rejected. Thus, it is inferred that there was a unique longrun equilibrium relationship between RGDP, MKTCAP, ASDMB and FINSTRUCT. The Johansen model is a form of Vector Error Correcting Model (VECM) where only one integrating relationship exists between the variables concerned (Hallam and Zanoli; 1993). The result of the integrating coefficient normalised on MKTCAP is presented as long-run estimates

#### Summary of the regression result

The model was transformed to the natural logarithm

$$\ln \text{GDP} = 227921.230 - 196.542 \text{LMCAP} + .007 \text{LADMB} + 463.212 \text{LLR} + 18963.930 \text{LFS}$$

$$\text{S.E} = (107037.766) (90.221)** (.006) (5753.132) (2347.118)**$$

$$R^2 = 0.737$$

$$\text{Adjusted } R^2 = 0.695$$

$$\text{P - value (F)} = 17.530$$

$$\text{DW} = 0.619$$

$$\text{Sig.} = 0.000$$

Note

\*\* statistically significant at  $p < .05$ .

Table 3

*Model Summary<sup>b</sup>*

Model	R	R Square	Adj.R Square	Std. Error	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
dimension 0	0.859 <sup>a</sup>	0.737	0.695	1.90658E5	0.737	17.530	4	25	.000	0.619

a. Predictors: (Constant), Financial Structure, Asset of deposit, market capitalization, Lending rate

b. Dependent Variable: RGDP

From the result so far, it is obvious clear that the variables in the model were highly correlated and have a significant impact on growth rate of GDP. The estimated model is a good one with desirable characteristics and the impact on growth rate of capital formation on economic growth and development has been established to depend on the trends in variables such as RGDP, Market capitalization, lending rate and financial structure. It can also be concluded from the result that there is relationship

### Summary and Conclusions

The study evaluated the structural relationship between capital market and economic growth in Nigeria from 1980 to 2009. The findings of the study reveal the following:

The regression result confirms that there exist positive relationship between the capital market and economic growth. The relationship is statistically significant. This implies that the activities of the capital market exert strong positive impact on economic growth in the Nigeria context. The result obtained also revealed that two of the predictors variables (Market capitalization and financial restructuring) are potent contributors to economic growth during the year under study. The statistical significant contribution of two independent variable (LnMCAP) and (LnFS) shows that a unit increase in LnMCAP and LnFS result in an increase in GDP. The implication of this is that the economy responds favourably to activities bordering on market capitalization and financial restructuring.

The study also reveals that the developed model is positive, significant and shows a direct relationship in the study of economic growth. Out of the four independent or predictor variables two shows statistical significant contribution in the prediction of the model while two did not. As it was observed capital market impact on economic growth via market capitalization, financial restructuring, this means that they are potent variables that are capable of influencing economic growth. Hence the capital market remain one of the mainstream in every economy that has the power to impact economic growth therefore the organised private sector is to invest in it. The Asset of deposit bank and lending rate does not impact significantly on the GDP while market capitalization and financial restructuring have significantly impact on the GDP. The government is therefore advised to create enabling environment that will attract investors and promote activities in the market for improvement in the declining market capitalization so that it could contribute significantly to the Nigeria economic growth.

### Policy Recommendations

Based on the findings made in the course of this study, the following recommendations are hereby suggested:

1. In order to improve market capitalization, foreign investors should be encouraged to partake in the capital market.
2. Responsible government agency should restore confidence to the capital market through ensuring transparency and fair trading transaction and dealing in the stock exchange. It must also call to order those who violate market rules.
3. Since financial restructuring is significant at 5% level of significance, therefore, they should increase in degree of openness in order to encourage foreign multinational companies (MNCs) or their subsidiaries to be listed on the Nigeria stock exchange, increase activities that will promote market turnover.

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