An Empirical Investigation of the Relationship between Nigerian Capital Market and Economic Growth (1986-2012)

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ABSTRACT: *The importance of Capital Market in economic growth and development of both developed and developing economies cannot be overemphasized as it helps in financial intermediation and stimulates growth. The Nigerian Capital Market has witnessed tremendous growth in recent years though it has not stimulated much economic growth. The paper examines the relationship between Nigerian Capital Market and economic growth using time series data from 1986 – 2012, co-integration and error correction techniques were used to ascertain whether there is the existence of long-run equilibrium relationship among variables used in the study. It was discovered that, there exists a long–run relationship between capital market indicators and its subsequent impact on the Nigerian economy, in addition, most of the funds raised in the market were short–term that were not suitable for longterm growth. It is recommended that, to improve the contribution of the Nigerian capital market to Gross Domestic Product, government should place embargo on the funding of development projects by both the public and private sectors through the capital market. Also government development project should be at least 70% funded by funds raised in the Capital market.*

Keywords: *Capital Market, Market Capitalization, Cointegration, Error Correction,*

I. INTRODUCTION

The importance of Capital Market in economic growth and development of both developed and developing economies cannot be overemphasized. The capital market mobilizes long term financial resources from surplus economic units to deficit units of the economy (Ariyo and Adelegan, 2006). The Nigerian Capital Market (NCM) commenced operations with the establishment of the former Lagos Stock Exchange Market (now renamed Nigerian Stock Exchange in 1961). It serves as a vehicle for the execution of government policies; broaden share ownership and attract foreign capital inflow into the Nigerian economy (Omole, 1997; CBN, 2000). The major dealers in the market are the development finance institutions, building societies, insurance companies, merchant and investment banks (Gusau, 2006). The reason for the establishment of the NCM include the following; to provide local opportunities for borrowing and lending for long term purposes; to assist in mobilizing long term capital for economic development; to provide foreign business with the facility to offer their shares for public subscription and an opportunity for Nigerian investors to participate in share ownership; to provide facilities for the quotation and marketability of shares and stocks and to provide a healthy and mutually acceptable environment for participation and co-operation of indigenous and expatriate capital in the joint effort to develop the Nigerian economy. It is important to note, however, that the federal government in 1996 set up a Committee to review the Nigeria's capital market and make appropriate recommendations. The Committee recommended among other things the establishment of more stock exchanges in the country in order to: stimulate competition, efficiency and modernization of the market; enable small and medium scale industrialist to source fund from the capital market, thereby contributing to economic growth and development. To this end, a number of measures were adopted in 1999 Fiscal Year with regards to the capital market reform in line with recommendations of the committee. This led to the establishment of the Abuja Stock Exchange toward the end of 2000. This is expected to stimulate competition and efficiency in the services provided by the market, thereby opening the market to other economies (see 1999 Federal Government Budget).

The NCM has witnessed tremendous growth in recent years. This growth was reflected by the increase in Capital Market indicators with All-Share Index rising from 5,226.4 in 1999 to 24,770.5 as at December 2010. Moreover, Market Capitalization rose from N294.1 billion in 1999 to N15.3 trillion as at the end of March 2008. The Banking sector Consolidation and other related reforms have impacted positively on Nigeria's Capital Market development (FGN, 2011). Moreover, there are other factors that led to the phenomenal growth of the Nigerian capital market. Some of these factors include; The Nigerian Enterprises Promotion of 1972; The

Indigenization Act of 1977; The establishment of Securities and Exchange Commission, (SEC) Act, that is the regulatory body of the capital market; the re-enactment of the Act as a Decree in 1988 to give the commission wider regulatory power; The repeal of the Nigerian Enterprises Promotion Decree and the subsequent establishment of the Nigerian Investment and Promotion Decree of 1995 to aid the inflow of foreign investments in the Nigerian economy (see Ajayi and Ojo; 2006). The recent economic reform programmes have facilitated the growth of the Nigeria's capital market. For example, economic reform programmes such as privatization, can impact positively on the growth and development of the capital market, especially if it is conducted on the stock exchange market. In Nigeria since the introduction of Privatization programme the capital market has grown very significantly (see for example, Megginson, 1998; Megginson and Boutchkova; 2000; Megginson et al; 2004; Dantama, 2008; Sanda and Dantama; 2011; Oke and Adeusi, 2012). It is against this, background that this paper examines empirically the relationship between Nigerian Capital Market and economic growth. This is very timely in view of the ongoing reforms in Nigeria's financial system. In order to achieve this objective this paper is divided into four   sections including this introduction. The second section reviews conceptual and and empirical literatures respectively. The third section is on methodology and results, while the fourth section concludes the paper.

II.   REVIEW OF LITERATURE

The term Capital Market has been a subject of considerable discourse in the literature. It deals with long term funds. It is divided into primary and secondary markets respectively. The primary market deals with the sales of new securities, while the secondary market deals with the old securities. In addition   the market comprises all transactions in financial instruments such as bank deposits bills, loans, claims against insurance companies, debentures, corporate shares, stock exchanges (see for example (CBN/ NDIC, 1995; Muhammed, 2004; Ajayi and Ojo, 2006). The importance of Capital Market in mobilization of resources, Capital formation and accelerating economic growth and economic development has been duly documented in the literature (Levine and Zervous; 1996; 1998; Muhammmed; 2004; Oluwatoyin and Ocheja; 2009; Donwa and Odia; 2010). The achievement of economic Growth is one of the goals of development policy in both developed and developing economies. It is a key element in assessing the overall living standards of the people and a weapon in the fight against poverty (UNDP/HDR 2008/2009). Economic Growth refers to the productive capacity of an economy identified by a sustained rise in the real National income (see Todaro, 1977; Jhingan, 2002). An increase in the growth rate of an economy is a reflection of an improvement in the socio-economic well being of its citizens. While a decrease in the growth rate of an economy is an indication of a decline in the living conditions of the people which leads to poverty (see Ijaiya et al,. 2011).

There are number of theories underpinning capital market in the literature. Such as the efficient market hypothesis (EMH) or the efficient market theory. EMH stresses the importance of information in share price movement and also a veritable tool for improving efficiency. Stock prices must be informational and efficient. The theory argues that capital market is very efficient in processing information and securities reflect all available information (Vickers and Yarrow; 1991, 2008; Dantama, 2008). The capital market is considered to be efficient in three respects: the weak form, semi- strong form and the strong form (see Kevin,).There is growing body of empirical literature on the relationship between Capital Market and Economic growth (see MccKinnon, 1973; Shaw; 1973; King and Levine; 1993; Levine; 1997; Demirguc-Kunt and Maksimovic; 1998. Rajan and Zingales; 1998; Subrahmanyam and Titman, 1999). Most of these studies have documented a positive relationship between Capital Market and economic growth. However, recent studies conducted on the impact of Capital Market on Nigeria's economic growth in the wake of 2008-2009 global financial and economic crises have revealed mixed results. A recent study by Adamu (2011) found a negative relationship between gross domestic product and economic growth during the period 2007 and 2009. The study recommended for effective and sound regulation to restore public and investor confidence in the economy. One of the weaknessess of the study is the short time span it covered which may not give the true insight of the situation, another weakness has to do with the generalizations based on the crictical time it covered where the global financial crises have distablized the capital markets of all countries of the world. The findings of the study have contardicted that of Owolabi (2011) who reported a positive relationship between stock market and economic growth.

In their own separate study, Oke and Adeusi (2012) employed Ordinary Least Square Method (OLS) and Johansen Co-Integration to examine the impact of capital market reforms on Nigeria's economic growth. The results revealed that the on-going reforms in the capital market have impacted positively on Nigeria's economic growth. However, the study recommended for a careful review of laws and economic reform agenda to enhance economic growth. The authors have however focused more on the ongoing reforms in the capital market, it howver assumed that with sound reforms the capital market can stimulate growth, the question here is how effective are these reforms and wether they are implemented effectively or not.

III. METHODOLOGY AND RESULTS

The data used in this study were secondary data sourced from Central Bank of Nigeria (CBN), Security and Exchange Commission (SEC), Nigeria Stock Exchange, Bureau of Statistics (BOS) and other secondary sources.

3.1 Model Specification

The Study obtained its model from the work of Adebiyi (2005), where the market capitalization is generally taken as a measure of stock market size, the market value of stocks, which are traded on the stock market. Also market liquidity was measured by the turn-over (total volume traded in the stock market), and the degree of activity in the market was indexed by the number of securities traded. Higher turnover is associated with low transaction cost. It also denotes the degree of activities on the stock market. Thus, a small but active stock market has a small size but a high turnover ratio.

The model specified for this study is illustrated as follows:

$$GDP = f\,(NOS,\ TVT,\ MTV,\ MKC\,) \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots..\ (1)$$

Thus the multiple regression function will be:

$$LogGDP_t = \beta_0 + \beta_1 LogNOS_t + \beta_2 LogTVT_t + \beta_3 LogMTV_t + \beta_4 LogMKCt + U_t \ldots\ldots\ldots\ldots\ldots\ldots\ (2)$$

Definition of variables:
GDP = Gross Domestic Product
NOS = Number of Securities or the stock market
TVT = Total Volume of stock Traded
MTV = Market Trading Value
MKC = Market Capitalization
U = stochastic or disturbance
t = Time period under investigation
β_0 = Intercept or the level of economic growth that is independent
β_1 to $\beta_4 > 0$.

The study employed econometric approach of estimation using the co-integration and error correction techniques. The time series properties of the variables are tested using the Augment Dickey Fuller (ADF) test. Prior to the conduct of the conventional regression analysis, there is the need to investigate the time series properties of the data as most time series often possess stochastic trend. Unit root test are required to ascertain whether or not the time series data are stationery. The test helps to avoid the problem of spurious regression. After the unit root test, the next step is to carry out a co-integration test to ascertain whether there is the existence of long-run equilibrium relationship among variables. ECM is used to conclude whether there exist a stable equilibrium relationship or not among variables.

Time Series Properties of the variables
TABLE 1: *Unit root test*

Variables	ADF Test	Critical value	Order Of Integration	Percentages
GDP	3.345**	3.003	I(2)	5%
NOS	2.643***	2.642	I(0)	10%
TVT	3.340**	3.004	I(0)	5%
MTV	4.122*	3.767	I(0)	1%
MKC	3.846*	3.786	I(1)	1%

Source: Researcher's computation using Eviews 7 Computer Software
*Significant at 1%
**Significant at 5%
***Significant at 10%

The null hypothesis of ADF test states the presence of unit root and is rejected only when ADF test is greater than critical value. Result shown in table 1 suggests that null hypothesis for each variable is rejected. So we conclude that there is no presence of unit root after testing all the variables.

TABLE 2: *Regression Result GDP as dependent variable*.

Variables	Coefficients	Standard Error	t-statistics	Probability
β_0	0.8360	5.1716	0.1616	0.8733
LogNOS	0.6006	1.0282	0.5841	0.5660
LogTVT	0.2509	0.1423	1.7635	0.0939
LogMTV	-0.2493	0.1541	-1.6180	0.1221
LogMKC	0.7291	0.2234	3.2633	0.0041

D.W. Statistics 1.18   F-statistics 324.1648 $R^2 = 0.99$ Adj $R^2 = 0.98$

Source: Researcher's computation using Eviews 7 Computer Software

The regression equation is represented below:

$$LogGDP = 0.8360 + 0.6006LogNOS + 0.2509LogTVT – 0.2493LogMTV + 0.7291LogMKC$$
$$(5.1716) \quad (1.0282) \quad\quad (0.1423) \quad\quad\quad (0.1541) \quad\quad\quad (0.2234)$$

In the estimated regression line above, βo (the constant term) is 0.8360. This means that holding Number of Securities (NOS), Total Volume Traded (TVT), Market Trading Value (MTV) and Market Capitalization (MKC) constant, the value of GDP will be ₦0.8360 Billion. The regression coefficient of NOS in the estimated regression line is 0.6006 which implies one percent increase in NOS tend to cause about 60.1% increase in GDP within the period under study. The calculated t-statistics for the parameter estimate of NOS is 0.58.

The tabulated t-statistics is 2.07. In the regression the value of the calculated t-statistics for NOS is less than the value of the tabulated t-statistics. This findings indicates that, the relationship between NOS and GDP is statistically not significant. The regression coefficient of TVT in the estimate regression line is 0.2509, which implies a percent increase in TVT tend to cause 25.1% increase in GDP within the period under study. The calculated t-statistics of TVT of the economy is 1.76. The tabulated is 2.07. The value of the calculated t-statistics for the TVT is less than the value of the tabulated t-statistics. This finding indicate the relationship between GDP and TVT is statistically not significant in the estimated regression line above. The regression coefficient of MTV is -0.2493 which implies that one percent increase in MTV tends to decrease GDP by about 24.9% within the period under study. The calculated t-statistics of MTV is -1.62 and the tabulated t-statistics is 2.07. The value of the calculated t-statistics of MTV is less than the value of tabulated t-statistics. This finding indicates that the relationship between GDP and MTV is not statistically significant. The regression coefficient of MKC in the estimated regression line is 0.7291 which implies that one percent increase in MKC tend to cause about 72.9% increase in GDP within the period under study. The calculated t-statistics for MKC is 3.26 and the tabulated t-statistics is 2.07. The value of the calculated t-statistics for MKC is greater than the value of the tabulated t-statistics.

Further, it was observed that the relationship between GDP and MKC is statistically significant in the estimated regression line above. The estimate of our model in table 2, indicates that the model is very robust with a strong predictive power with an interesting strong goodness of fit. The result shows a R^2 of 0.99 which suggest that about 99% of the change in GDP is accounted for by the independent variables in the model while the remaining 1% is accounted for by factors not captured by the model. The robustness and goodness of fit of the model is further confirmed by a strong adjusted R^2 of 0.98. It shows that 98% of variation in GDP (our proxy for economic growth) is caused by variation in the explanatory variables (Number of Securities, Total Volume Traded, Market Trading Value and Market Capitalization). The Durbin-Watson statistics is 1.18 which shows that positive serial correlation exist in the regression equation.

3.2 Tests for Cointegration

Here, we investigate for the existence of any unique equilibrium relationship(s) among the stationary variable of the different order of integration. The Johansen methodology is a VAR based approach. The result based on VARs is generally found to be sensitive to the lag length used and this compelled us to devote a considerable time to the selection of the lag structure. Various lag lengths were chosen by minimizing the Akaike information criterion. The selected lag length(s) are thus those that reduce autocorrelation in the model. Having tested our time–series for stationarity, the next step of our time-series analysis is testing for co-integration which amounts to checking whether the linear combination of the variable is also stationary or not. It requires that the variable of interest have the same order of integration. It is only when the variable are integrated of the same order that a linear relationship among them can be expected. Variable are said to be co-integrated if a long-run relationship exist among them. Engle and Granger (1987) argue that for such relationship to exist error term of the model should be stationary. We have applied the Engle-Granger procedure to test for co-integration. The first stage of the co-integration test involves estimating model\equation (2) and

saving the error terms. Then the DF and ADF tests are applied on the error term. If the error term is found to be stationary, the variable are said to be co-integrated and this necessitates the estimation of an error correction model involving long-run relationship. If on the other hand, the variables are not co-integrated, then the modelling should proceed with the differenced time-series. From the cointegrated test conducted, starting with likelihood ratio test association with upper part of the table, the null hypothesis of no cointegration vectors are rejected since the likelihood ratio test of about 97.36519 is greater than the critical value of about 68.52 at 5% level. This further suggest in the null hypothesis there are at most non-cointegration vector is rejected. Furthermore, we reject null hypothesis that there are at most 1 cointegration vector is rejected since the likelihood ratio test of about 55.61070 is greater than the critical value of 47.21 at 5%. The null hypothesis that there are at most 2 co integrating vector is accepted since the likelihood ratio test of about 29.10759 is less than the critical value of 29.68 at 5% level. However, we accept the null hypothesis that there are at most 3 co integrating vector is accepted since the likelihood ratio test of about 15.25662 is less than the critical value of 15.41 at 5% level. Therefore, it is worth nothing from the cointegration test that, there are at least 2 cointegration relationships between the variable under consideration as revealed by the test. In each case therefore, the null hypothesis of no cointegration between the variable is rejected if the likelihood ratio is greater than the critical value and vice-versa. It can be observed from the analysis that, there are 2 co integrating relationship as mention earlier because the test revealed the acceptance of alternative hypothesis at 2 levels (at most 2, and at most 3).

3.3 Error Correction Model (ECM)

Since the test for cointegration reveals 2 integrating relationship amongst the variables. The likelihood ratio is greater than the 5% as well as 1% critical value. This suggests the existence of 2 integrating or long–run relationship among the variables as the test suggest the rejection of null hypothesis of no co integrating relationships. As the test revealed evidence of cointegration the result could be estimated using error correction model. The error correction captures the dynamic long–run relationship among variables. The notion supported by (Wicken, 1996) point out that for the restriction to be meaningful, the adjustment coefficient must be statistically significant and their sign must be negative if not check for the error correction model stability. The ECM estimation outputs reports the results from the Johanson procedure. It treat the first r variable in the ECM as function of the remaining k–r variable were r is the number of co integrating equations and k is the number of endogenous variables

Table 3: Normalised Ecm Coefficients.

Variable	Vector coefficient β	Error correction adjustment coefficient α
NOS (-0)*	**-1.057026** (0.38770) (-2.72640)	**-1.057026** (0.38770) (-2.72640)
TVT (-0)*	**-12.87475** (4.49252) (-2.86582)	**-12.87475** (4.4925) (-2.86582)
MTV (-0)*	**-7.07714** (5.75848) (-1.22900)	**-7.07714** (5.75848) (-1.22900)
MKC (-1)*	**-4.014967** (3.45826) (-1.16098)	**2.574814** (3.89368) (0.66128)

Source: Researcher's computation using Eviews 7 Computer Software () upper & () Lower reports values of Standard error and t-ratios respectively.*Indicates Significant at 5% level.**Indicates Significant at 1% level.***Indicates Significant at 10% level.

From the above, a long–run co integrating vector coefficient of the model shows a situation where by the Gross Domestic Product (GDP) was used as dependent variable and shows all the other ECM coefficient are statistically significant at 1%, 5% and 10% level. That is the Number of Securities (NOS), Total Trading Value (TVT), Market Trading Value (MTV) and Market Capitalization (MKC) is significance at 1%, 5% and 10% level. The Number of Securities (NOS) was found to be insignificant to the growing of the economy, and the variable has a negative sign. The results illustrated that the Number of Securities (NOS), Total Volume Traded (TVT), Market Trading Value (MTV) and Market Capitalization (MKC) are statistically insignificant but positively related to GDP. Similarly, the implication of this result is that the quality of Number of Securities (NOS), Total Volume Traded (TVT), Market Trading Value (MTV) and Market Capitalization (MKC) in

Nigeria is low. For any significant contribution of Number of Securities (NOS), Total Volume traded (TVT), Market Trading Value (MTV) and Market Capitalization (MKC) to economic growth there is the need for concerted development in a new and innovative way. The measure of Number of Securities (NOS), Total Volume Traded (TVT), Market Trading Value (MTV) and Market Capitalization (MKC) obtained for Nigeria is low relative to developed countries. The results reveals that 1% increase in Number of Securities (NOS), Total Volume Traded (TVT), Market Trading Value (MTV), and Market Capitalization (MKC) are amount to 10.5%, 128.7%, 70.7% and 40.1% respectively decrease in GDP, the non significance of the NOS, TVT, MTV and MKC indicates the need for increase in total value of all equity securities listed in the stock exchange and reduce the prevailing market price to enhance the economic growth. The higher the GDP growth, the higher the level of economic growth.

While the adjustment parameters of the coefficient of the ECM model were also reported as ECT is associated with long run relationship between GDP and NOS which is -1.0570, meaning that the government should increase more of the Number of Securities (NOS) by allowing for both citizens and foreign investors to participate in the economy by 10.57% for the economy to reach the targeted rate of economic growth. The adjustment parameters of the coefficient of the ECM for the Total Volume Trade (TVT), the ECT is still negative showing that the relationship between the variable is -12.87 means that government should increase Total Volume Traded (TVT) by 128.7% for the economy to achieve full level of economic growth, while for the adjustment parameters of the coefficient of the ECM for the MTV is also negative showing that the relationship between the variables -7.077, for the restoration of the long–run equilibrium. Meaning that, the government should encourage the MTV into the economy by 70.77%.

IV. CONCLUDING REMARKS

Capital market is the prime motor that drives any economy. It was discovered that, there exists a long–run relationship between capital market indicators and its subsequent impact on the economy. On the basis of the above findings, Nigerian capital market has not fully performed its natural function of funding investment and stimulating growth because the proportion of the market share represented in the national economy is infinitesimal to drive the economy. Most of the funds raised in Nigeria were short–term money market and these are not growth funds. It was therefore, not surprising that Nigerian economy has only been growing at very low rate over the period. A growth–driven economy needs the money market only as a source of liquidity and working capital but as a provider of financial feed stock to the capital market. It has therefore become necessary that the perspective of Nigerians about investment and raising funds in the market be re-evaluated and the market rebranded to propel growth and improve social well being of Nigerians. The following recommendations are hereby made in order to deepen the Nigerian capital market. Since capital market is a strong determinant of capital formation (investment) and growth in the long-run, there is the need for both the private and public sectors to pursue economic and financial policy reform that encourage investment in the market. For instance through collective investment scheme like unit trust, venture capital fund and community saving scheme, funds can be pooled together and eventually channelled for investment through the market. To improve the contribution of the market to Gross Domestic Product (GDP) and economic growth, government should place embargo on the funding of development projects by both the public and private sectors through the capital market. Government development project should be at least 70% funded by funds raised in the market.

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