Research Journal of Finance and Accounting www.iiste.org
ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online)
Vol.6, No.3, 2015

Nigerian Capital Market: A Catalyst for Sustainable Economic Development

ABU IKPONMWOSA NORUWA
DEPARTMENT OF FINANCE,UNIVERSITY OF LAGOS
abuikponmwosa@yahoo.com

AGUDA NIYI A.
BANKING AND FINANCE DEPARTMENT,WAZIRI UMARU FEDERAL POLYTECHNIC, BIRNIN KEBBI,PMB 1034, KEBBI STATE
niyiaguda1424@yahoo.com

1.1 Introduction

The capital market is the segment of the financial market which facilitates the mobilization and allocation of medium and long-term funds through the issuance and trading of financial instruments. Such instruments, otherwise known as securities, include stocks and company shares; commercial and industrial loan stocks and debentures; state government bonds and stocks; Federal government Development stock bonds,(Oloyede,2001). While equities represent ownership stake in a company which issued them, bonds are debt instruments with the principal and interest usually payable to the bondholder at specific periods.

The main **participants** of the Nigerian capital market are the Securities and Exchange Commission (regulatory), Nigerian Stock Exchange, stock brokers, trustees, issuing houses, registrars. The investments are done by the insurance companies, pension funds, institutional investors and the individual investors. Ekezie (1997) also included the CBN for its promotional and participatory roles in the market.

The Capital market is made up of two inter-related segments. The primary market is the mechanism for raising funds through the issuance of new securities. The secondary market essentially provides facilities for trading in (transferring) already issued securities, thereby creating liquidity in the market.

As the major source of appropriate long-term funds, the capital market is obviously crucial to any nation's economic development. Specifically, the capital market facilitates economic growth by, among other things, mobilizing savings from numerous economic units such as governments, individuals and institutional investors for users such as governments and the private sector. It also improves the efficiency of capital allocation through a competitive pricing mechanism. Samuel, et al(2007) note that the capital market through its operations will continue to provide avenues for government and large enterprises to obtain financing and capital base broadening.

In pursuance of making funds available for economic development and growth the Securities and Exchange Commission was established in 1979 by the Securities and Exchange Commission Decree (this decree was re-enacted in 1988 as Securities and Exchange Commission Decree no. 29 of 1988, for the purpose of protecting the investors as well developing the capital market. A detailed review of the Nigerian Capital Market was carried out in 1996. This led to the enactment of the "Investment Securities Act (ISA) No.45 of 1999 (and the regulations made thereunder). This Act replaced the Securities and Exchange Commission Decree No.29 of 1988. It aimed at providing a more efficient and viable capital market positioned tomeet the country's economic and Developmental needs.

Obademi O.E and Adeyanju O.D (2010) observe that a changing and growing economy like Nigeria needs enormous amount of funds to fully explore the opportunities opened up by the reforms which was anchored on the National Economic Empowerment And Development Strategy blueprint and now the Vision 20-2020. This is where the capital market's role comes in as it is expected to play the traditional role of financial intermediation by pulling financial resources from surplus units to deficit units and end-users for productive economic purposes even at this time of unpredictable revenue from crude oil being a fall-out the global financial crisis.

2. 0 LITERATURE REVIEW AND THEORETICAL FRAMEWORK

There have been the growing concerns and controversies on the role of the Stock markets on economic growth and development (Oyejide 1994; Levine and Zervos 1996;Demirgue-kunt and Levine 1996;Nyong 1997;Obadan 1998; Sule and Momoh 2009; Ewah,Esang and Bassey 2009).There have been mixed results; while some are in support of a positive link, some negative link and others do not find any empirical evidence to support such conclusion. For instance, Atje and Jovanovic (1993) found in a cross-country study of stock and economic growth of 40 countries from 1980 to 1988 that there was a significant correlation between the average economic growth and stock market capitalization. Levine and Zervos (1996) examined whether there was a strong empirical relationship between stock market development and long-run economic growth. They found a strong correlation between overall stock market development and long-run economic growth. Demiurgic-Kunt and Levine (1996) using data from 44 countries for the period 1986 to 1993 found that different measures of stock exchange size are strongly correlated to other indicators of activity levels of financial, banking, non-banking institutions as well as to insurance companies and pension funds. They concluded that countries with well-developed stock markets tend to also have well-developed financial intermediaries.

Again, Demiurgic-Kunt and Maksimovic(1998) have shown and re-emphasized the complementary role of the stock market and banks that they were not rival or alternative institutions using 30 countries from 1980 to 1991. Levine and Zervos (1998) used pooled cross-country time series regression of 47 countries from 1976 to 1993 to evaluate whether stock market liquidity is related to growth, capital accumulation and productivity. They towed the line of Demiurgic-Kunt and Levine (1996) by conglomerating measures such as stock market size, liquidity and integration with world market, into index of stock market development. The rate of Gross Domestic Product (GDP) per capita was regressed on a variety of variables designed to control for initial conditions, political instability, investment in human capital and macro economic condition and then, included the conglomerated index of stock market development. They found empirically that the measures of stock market liquidity were strongly related to growth, capital accumulation and productivity while stock market size does not seems to correlate to economic growth. Nyong (1997) developed an aggregate index of capital market development and used it to determine its relationship with long-run economic growth in Nigeria. The study employed a time series data from 1970 to 1994. Four measures of capital market development-ratio of market capitalization to GDP (in %), ratio of total value of transactions on the main stock exchange to GDP (in %), the value of equities transactions relative to GDP and listing were used. The four measures were combined into one overall composite index [p]===]\][\l market development using principal component analysis. The financial market depth was included as control. It was found that the capital market development is negatively and significantly correlated with the long-run growth in Nigeria. Demiurgic-Kunt and Maksimovic (1998) cited in Henry (2000) found a relationship between economic growth and the stock market activity in

the field of transmission of security (secondary market) more than in funds channeling (primary market). Barlett (2000) demonstrated that a rising stock price raises the wealth of the economy (wealth effect) by encouraging increase in consumers consumption and increase in investment. Ewan et al. (2009) appraise the impact of the capital market efficiency on the economic growth of Nigeria using time series data from 1961 to 2004.They found 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. Harris (1997) did not find hard evidence that stock market activity affects the level of economic growth.

3.0THE CAPITAL MARKET AND NIGERIA'S ECONOMIC DEVELOPMENT

According to Obademi O.E and Adeyanju O.D (2010) considering the needed magnitude of growth in real resources and their allocation within an economy, financial markets are germane to the quest for growth not minding the claim that sometimes asset valuation may not adequately reflect the rate of return in investment in productive capacity. The fact is that the capital market cannot be overlooked nor wished away by any nation that is serious about achieving economic growth. The failure of state directed credit to achieve economic growth makes it imperative for the capital market to take the lead.

Also the fact that bank financial investment is often not enough makes the capital market important considering the quantum of funds in dollar conversion of what is needed for development projects after the naira devaluation and the global competitiveness of foreign direct investment quest by developing countries around the world. Moreover, retained profits are no more sufficient for expansion in the face of the present information technology revolution. The situation has been further worsened with the endemic crisis in the banking industry.

The capital market thus among others help in financing the savings-investment gap both domestically and internationally as well as finance other activities that can result in economic growth. Ordinarily the need for long term finance makes the capital market relevant to our development drive. It is common knowledge that in Nigeria in the last few years as a consequence of the liberalisation, privatisation and re-capitalisation policies of the government that has swept across the telecommunication, energy, manufacturing, banking and insurance sub-sector, the capital market has played enviable roles in the attainment of the objectives of the government in pushing up the growth figures and enhanced human welfare coupled with the redistribution of income and benefits within the Nigerian business environment.

Levine et al (1997), in their study on the compatibility of stock market development with financial intermediaries and economic growth posited that stock market development is positively correlated with the development of financial intermediaries and long term economic growth. In Nigeria in recent times, the bank re-capitalisation exercise was facilitated by the capital market.

Sule K.O and Momoh C.O (2009) note that there are a lot of investment opportunities available in the

Nigerian Capital Market. The ultimate aim is to create wealth and improve the welfare of the average Nigerian, which automatically translates in the nation‟s per capita income. Stock Exchanges play an increasingly important role, not only for channeling resources, but also for promoting reforms to modernize the financial sector legislation as is experienced in Nigeria and other emerging economies. In a study published at the beginning of the nineties, Levien (1991) points out two key arguments on how stock exchanges speed up the economic growth. The first is by making property changes possible in the companies, whilst not affecting their productive process; the second is by offering higher possibilities of portfolio diversification to the agents.
Economic growth in a modern economy is hinged on an efficient and effective financial sector that pools domestic savings and mobilizes capital for productive projects. Absence of effective capital market could leave most productive projects which carry developmental agenda unexploited. Because capital market connects the monetary sector with the real sector and therefore facilitates growth in the real sector and economic development, thereby improving the quality of lives of the citizenry.

The stakeholders ,who also advocated stick and carrot measure as a solution to the growing infraction in the nation's capital market, identified **the fundamental channels through which capital market is connected to economic growth and development as follows:**

(1) Capital market increases the proportion of long-term savings (pensions, funeral covers, etc) that is channeled to long-term investment. Capital market enables contractual savings industry (pension and provident funds, insurance companies, medical aid schemes, collective investment schemes, etc) to mobilize long-term savings from small individual household and channel them into long-term investments.

(2) Capital market also provides equity capital and infrastructure development capital that has strong socio-economic benefits through development of roads, water and sewer systems, housing, energy, telecommunications, public transport, etc.

(3) Moreover, capital market promotes public-private sector partnerships to encourage participation of private sector in productive investments. The need to shift economic development from public to private sector to enhance economic productivity has become inevitable as resources continue to diminish. It assists the public sector to close resource gap, and complement its effort in financing essential socio-economic development, through raising long-term project based capital.

(4) It also attracts foreign portfolio investors who are critical in supplementing the domestic savings levels. It facilitates inflows of foreign financial resources into the domestic economy.

According to Donwa P. and Odia J.,(2010) in 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). Ekundayo (2002) argues that a nation requires a lot of local and foreign investments to attain sustainable economic growth and development and the capital market provides a means through which this is made possible. However, the paucity of long-term capital has posed the greatest predicament to economic development in most African countries including Nigeria.

Osaze (2000) sees the capital market as the driver of any economy to growth and development because it is essential for the long term growth capital formation. It is crucial in the mobilization of savings and channeling of such savings to profitable self-liquidating investment. The Nigerian capital market provides the necessary lubricant that keeps turning the wheel of the economy. It not only provides the funds required for investment but also efficiently allocates these funds to projects of best returns to fund owners. This allocative function is critical in determining the overall growth of the economy. The functioning of the capital market affects liquidity, acquisition of information about firms, risk diversification, savings mobilization and corporate control (Anyanwu 1998). Therefore, by altering the quality of these services, the functioning of stock markets can alter the rate of economic growth (Equakun 2005). Okereke-Onyiuke (2000) posits that the cheap source of funds from the capital market remain a critical element in the sustainable development of the economy. She enumerated the advantages of capital market financing to include no short repayment period as funds are held for medium and long term period or in perpetuity, funds to state and local government without pressures and ample time to repay loans.

Again the capital market was instrumental to the initial 25 banks that were able to meet the minimum capital requirement of N25billion during the banking sector consolidation in 2005.The stock market has helped government and corporate entities to raise long term capital for financing new projects ,and expanding and modernizing industrial / commercial concerns (Nwankwo 1991) .

4.1 Roles of the Capital Market

According to Al-Faki (2006), the capital market is a "network of specialized financial institutions, series of mechanisms, processes and infrastructure that, in various ways, facilitate the bringing together of suppliers and users of medium to long term capital for investment in socio-economic developmental projects". The capital market is divided into the primary and the secondary market. The primary market or the new issues market provides the avenue through which government and corporate bodies raise fresh funds through the issuance of securities which is subscribed to by the general public or a selected group of investors. The secondary market provides an avenue for sale and purchase of existing securities. Sule and Momoh (2009) found that the secondary market activities have impacted more on Nigeria per capita income by tending to grow stock market earnings through wealth than the primary market. The roles of the capital market in the development of the economy include:

(1) It provides opportunities for companies to borrow funds needed for long-term investment purposes.

(2) It provides avenue for the marketing of shares and other securities in order to raise fresh funds for expansion of operations leading to increase in output/production.

(3) It provides a means of allocating the nations real and financial resources between various industries and companies. Through the capital formation and allocation mechanism the capital market ensures an efficient and effective distribution of the scarce resources for the optimal benefit to the economy.

(4) It reduces the over reliance of the corporate sector on short term financing for long term projects and also provides opportunities for government to finance projects aimed at providing essential amenities for socioeconomic development.

(5) The capital market can aid the government in its privatization programme by offering her shares in the public enterprises to members of the public through the stock exchange.

(6) The capital market also encourages the inflow of foreign capital when foreign companies or investors invest in domestic securities, provides needed seed money for creative capital development and acts as a reliable medium for broadening the ownership base of family-owned and dominated firms.

4.2 Contribution of the Capital Market to Socio-economic Development of Nigeria

The capital market is very vital to the growth, development and strength of any country because it supports government and corporate initiatives, finances the exploitation of new ideas and facilitates the management of financial risk. The rate of economic growth has been inexonerably linked to the sophistication of the financial market and capital market efficiency. Both markets facilitate the mobilization and channeling of funds into productive constituents and ensuring that the funds are used for the pursuit of socioeconomic growth and development without being idle (Akinbohungbe1996; Adebiyi 2005)

From 1961, the Nigerian capital market has growth tremendously, particularly during the periods of the indigenization decrees of 1972 and 1977. The securities increased from 8 in 1961 to about 301 in 2008. Over the years, the Nigerian capital market has witnessed relatively stability and also recorded impressive growth. This has positioned it to positively impact the economy. There is clear evidence that the capital market remained an important source of capital for the nation's economic development in financing infrastructural projects, the privatization programme of the government and banking sector recapitalization in Nigeria. Sule and Momoh (2009) conclude that the recent consolidation exercise of major financial institutions and privatization exercise of most publicly owned enterprises are key indications of government faith in the capital market to drive growth of the Nigerian economy.

4.2.1 Financing Government's Infrastructural Projects

The capital market has been a viable source of financing state and local government infrastructural projects and developmental strides with less pressures and lean on resources. The first State to use the capital market was the defunct Bendel State which issued a ten year N20 million 7% Bendel State of Nigerian Loan Stock in 1978.The maturity was in 1988 (Okereke-Onyiuke 2000).The issue was to finance a housing project. Ogun State went to the market in 1986 to rise a N15 million 12% First Ogun State Government Loan Stock with a maturity date of 1996. The bond was issued to finance the construction of a water project in Abeokuta. The Lagos State Government accessed the capital market in 1987 and 1988 with two tranches of its revenue bond for the development of the first and second phase of the Lekki peninsula. The first tranche was N30 million while the second tranche was N60 million or an aggregate of N90 million raised by the Lagos state government. Oyo State Government raised 16.5% N30billion Revenue Bond in 1999 to build the Gbagi market and the Adamasingba complex. Also, the Kaduna State Government raised N30 million each from the market in 1989 and 1993 to finance the development of the Kadia Ginger processing factory. Edo State Government went to the market to raise the first Edo State 21% N500 million Floating Rate Revenue Bond 2002/2006. It was used to finance the renovation the Samuel Ogbemudia stadium and other projects. Lagos Island Local Government has also tapped from the capital market to finance a shopping complex – the Sura shopping complex. The bond carried a total amount of N100 million and an interest rate of 24.75% (SEC 2002).

Over the years, some States have gone to the capital market to source for funds to finance their developmental projects. For instance, Yobe State raised N2.5 billon in 2001 to finance urban roads, houses and drainage improvement. Ekiti State raised N4 billion in 2002 to finance the construction and rehabilitation of some of its urban and rural roads, establishment of palm plantation, rural electricity and expansion of water project. Lagos

State raised N15 billion in 2003 to refinance short term facilities obtained from banks to fund developmental projects. Cross River State raised N4 billion to upgrade and expand Obudu Ranch Resort. Akwa-Ibom State raised N6 billion to finance infrastructural development, Delta State raised N5 billion to finance market, Health care, water and education and Edo State raised N1billion to finance development of Ogba Riverside Housing Estate. Osaze (1995) while bemoaning the low level at which State and local Governments sought funds from the market stressed the capital market could also be a veritable source of funding for the cash-trapped Nigerian universities yet to be harnessed.

4.2.2 Privatization of State Owned Enterprises

The Nigerian Capital Market played a paramount role in the privatization of the State
Owned Enterprises by giving creditability and transparency to the exercise. Within four of the privatization and commercialization decree, 88 were privatized out of 111 SOEs realizing a gross proceeds of N3.7 billion (Anyanwu et al. 1997). Between 1989 and 2001, a total of N25.6 billion was realized from the exercise. Also, the shares of the SOEs were sold to Nigerians and associations in all local government through public offers

4.2.3 Bank Re-capitalization and Consolidation in Nigeria

The bank recapitalization to N25 billion in which 25 banks (but presently 24 banks after Stanbic and IBTC bank merged) emerged from the previous 89 banks clearly revealed the importance of the capital market, In fact, most of the banks in Nigeria were able to raise the required capital after going to the capital market through initial public offerings. Soludo (2006) reports that about $650 million was invested in the banking sector in 2005. Al Faki (2006) puts the figure that was raised from the capital market by banks to meet the minimum capital requirement of N25billion as over N406.4 billion.

4.2.4 Capital market provides avenue for FDI for economic growth in Nigeria

There is a growing body of empirical literature considering FDI inflows as a catalyst of economic growth. FDI provide host countries with much needed capital, technology; expertise and new
managerial skills topped with some access to international export markets. Chen *et al.* (1995) report that FDI inflows are positively correlated with post-1978 economic growth in China by contributing to capital formation, export earnings, and bringing about advanced managerial skills. Blomstrom *et al.* (1992) finds similar evidence using a panel data from 78 developing countries where technological upgrading and knowledge spillovers are the vehicle through which FDI stimulates growth. Hence the Nigerian capital market provides avenue for FDI in the country for economic growth.

CONCLUSION

Hence as the major source of appropriate long-term funds, the capital market is obviously crucial to any nation's economic development. Specifically, the capital market facilitates economic growth by, among other things, mobilizing savings from numerous economic units such as governments, individuals and institutional investors for users such as governments and the private sector. Considering the needed magnitude of growth in real resources and their allocation within an economy, financial markets are germane to the quest for growth not minding the claim that sometimes asset valuation may not adequately reflect the rate of return in investment in productive capacity.

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