EFFECT OF THE NIGERIAN CAPITAL MARKET OPERATIONS ON THE LOCAL INVESTMENTS IN NIGERIA

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ABSTRACT

This paper, examines the effect of the Nigerian capital market operations on the local investments in Nigeria. The main objectives highlighted, is to empirically analyze the effect of the Nigerian capital market operations on local investment. The relevance of the capital in the encouragement of local investment and economic development were highlighted. The paper concludes with recommendation to stem up investors confidence and activities in the capital market so that it could contribute significantly to the growth of local investment in Nigeria.

Keywords: Financial market, Local investment, financial intermediation, economic growth, capital market

INTRODUCTION

The capital market has been identified as an institution which contributes to the socio-economic growth and development of emerging and developed economies. (Okafor: 1983, CBN: 2007). This is made possible through some of the vital roles it play such as channeling resources, promoting reforms to modernize the financial intermediation capacity sector to link deficit to the surplus sector of the economy, mobilization and allocation of savings among competitive uses which are critical to local investment (Allied 1984, ibenta:2000).

It helps to channel capital or long-term resources to firms with relatively high and increasing productivity, thus enhancing economic expansion and growth (Allied, 1997). 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. However, the paucity of long-term capital has posed a great challenge to economic development in most African countries including Nigeria. Osaeze (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. (Alile and Anao 1986, Okafor 1980) The Nigerian capital market provides the necessary lubrication that keeps turning the wheel of the economy. It does not only provide the funds required for investment but also efficiently allocates these funds to projects of best returns to fund owners. This locative functions 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 (Nwankwo , 1987;ojo,1998). Therefore, by altering the quality of these services, the functioning of stock markets can alter the rate of local investment (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 periods 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.

The current clamor for local investment cannot therefore be overemphasized, and hence the relevance of this paper at the crucial time.

This paper is splitted into five sections. The first section is of course the introduction. Section two and three are devoted to literature review and methodology. Section four is concerned with discussion of findings, while section five is devoted to conclusion and recommendation.

Objectives of the study

The objective of this study is to empirically analyze the effect of the capital market operations on local investment in Nigeria. The boost in local investment is proxy by the gross domestic product (GDP) while the capital market variables considered are market capitalization, total new issues, volume of transaction and total listed equities and Government stock. In addition to make suggestions to enhance the contribution of the Nigerian capital market to local investment in Nigeria.

Literature Review

In 1986, Nigeria embraced the International Monetary Fund (IMF) World Bank Structural Adjustment Programme (SAP) which influence the economic policies of the Nigerian government and led to reforms in the late 1980s and early 1990s. The programme was proposed as an economic packaged to rapidly and effectively transform the Nigerian economy within two years (Oyefusi, 1996, ibenta, 2000).

However, until SAP was abandoned in 1994, the objectives were not achieved due to the inability of government to judiciously implement some of its policy measures (Oyefusi and Mogbolu, 2003).

The notable reforms include monetary and fiscal policies, sectoral reforms such as removal of oil subsidy in 1988 to the tune of 80%, interest deregulation from August 1987, and financial market reform cum public sector.

There have been growing concerns and controversies on the role of the stock markets and local investment (Oyejide, 1994). Levine and Zervos (1996) examines whether or not 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) found that different measures of stock exchange size are strongly correlated to other indicators of activity level 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 Maksi-movic (1998) have shown and re-emphasized the complementary role of the stock market and banks that they were not rival or alternative institutions.

The rate of Gross Domestic Product (GDP) per capita was regressed on a variety of variables designed to control political instability, investment in human capital and macroeconomic 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 did not seem to correlate with increased local investments.

The Financial Market

The international financial market over the world has grown very fast in the recent years. The private capital market is consistently improving since 1997. The buoyant capital flows among the nation boundaries have raised the existing strength of the financial market domestically as well as internationally.

The markets over the world, particularly the financial markets are largely affected by the hedge funds. The use of hedge funds has allowed the trading activities with large number of dealers.

Traditionally the banks were involved in the activities of lending and receiving deposits. In the recent years banking sector among the countries over the world are the main area of concerns in the financial activities with rendition of a large number of services.

Banking sector has a major role in developing the financial sector in the rural area as with the result of failing transaction cost on investment.

The financial markets can be majorly divided into money and capital market. (Okafor, 1983)

Money markets are markets for borrowing and lending money for three years or less. The securities in a money market can be government bonds, treasury bills and commercial paper from banks and companies, CBN certificate.

A money market is simply be defined as a market consisting of financial institutions and other dealers in short-term money and credit who either want to lend or borrow money. (Adekanye, 1986). It is the continual buying and selling of short-term liquid investments. The trading of highly liquid short-term assets and securities such as treasury bills and commercial papers, Bankers acceptances certificate of deposit, bills of exchange etc. The life span of such funds usually ranges from few hours to about twenty-four months or two years. (Ekiran, 1999). The money market is often, though not always, included in counts of the money supply. One may be on the money market either on an exchange or over the counter.

The capital market on the other hand is a market where both government and companies raise long term funds to trade securities on the bond and the stock market. (Okafor, 1983). It consists of primary market where new issues are distributed among investors and the secondary markets where already existing securities are traded.

In the capital market, mortgages, bonds, equities and other such investment funds are traded. The capital market also facilitates the procedure whereby investors with excess funds can channel them to investors in deficit.

The capital market provides both overnight and long term funds and uses financial instruments with long maturity periods. The following financial instrument traded in this market includes foreign exchange instruments, equity insurance credit market derivatives and hybrid instruments. (Ekiran, 1999)

Historical Background of the Nigeria Stock Exchange

The Nigerian Stock Exchange (NSE) was formed in 1960, as Lagos Stock Exchange, which was backed by law in 1961. In December 1977, the name was changed to The Nigerian Stock Exchange. Currently, The Nigerian Stock Exchange (NSE) consists of six branches and the Head office is in Lagos, but has an office in Abuja. The trading system of the NSE is fully automated.

The Nigerian Stock Exchange commenced operations in 1961 with 19 securities enrolled for trading but at present, the numbers of enrolled securities is 282. The Lagos branch was launched in 1961; Kaduna, 1978; Port Hacourt, 1980; Kano, 1989; Onitsha February 1990; and Ibadan August 1990; Abuja, October 1999 and Yola April 2002. In 1988, The Nigerian Stock Exchange management protested to the government about the report on the reform of Nigeria's capital market.

The importance of the Capital Market to the development of the Nigerian Economy

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 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 capital 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. Provision of an additional channel for engaging and mobilizing domestic savings for productive investment.

2. Improving the efficiency of capital.
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 local investors.
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 act as a reliable medium for broadening the ownership base of family owned and dominated firms.

Facilitating the transfer of business enterprises from the public sector to the private sector.(CBN,2007)

METHODOLOGY

Secondary data are used in this research. The data were collected from the Nigerian Stock Exchange (NSE). Fact Books, Security and Exchange Commission (SEC), Market Bulletins and Central Bank of Nigeria (CBN) statistical bulletins. The data are empirically analyzed and results are discussed.

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 of capital 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) ,Henry (2000) found a relationship between loan investment 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 consumption and increase in investment.

Ewan et al. (2009) appraise the impact of the capital market efficiency on local investment in Nigeria. 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, illiquidity, misappropriation of funds among others. Harris (1997) did not find hard evidence that stock market activity affects the level of local investment.

DISCUSSION OF FINDINGS

It was found that the capital market in Nigeria has the potential for growth inducing but has not contributed meaningfully to the economic growth of Nigeria due to low market capitalization, small market size, few listed companies, low volume of transactions, low absorptive capitalization, illiquidity etc. also our result supports Dimirgue Kunt and Asli (1996) and Haris (1997) who found hard evidence and strong positive relationship between stock market and increased local investment.

It was also gathered that the capital market allows many Nigerians to invest their excess cash in the stock exchange thereby leading to economic growth of the country.

Conclusion and Recommendations

In order for the Nigerian capital market to be a pivotal force in Nigeria socio-economic growth and development and encouragement of local investment, the following suggestions are put forward:

1. First, improvement in the declining market capitalization by encouraging more foreign investors to participate in the market, maintain state of the art technology like automated trading and settlement practices, electronic fund clearance and eliminate physical transfer to shares.
2. There is also need to restore confidence to the market by regulatory authorities through ensuring transparency and fair trading transactions and dealings in the stock exchange. It must also address the reported cases of abuses and sharp practices by some companies in the market.
3. Moreover, the total listing in the NSE is still a far cry compared to other stock exchanges like South Africa and Egypt. Therefore, to increase the number of listed companies there is need to ensure stable macroeconomic environment, encourage both local and foreign multinational companies (MNCs) or their subsidiaries to be listed on the Nigerian Stock Exchange, relax the listing requirements to the first tier market and ensure tax rationalization in the capital market to encourage quotation and public interest in shareholdings. For new issues, increase the minimum equity capital requirements for companies other than banks, insurance companies and other financial institutions, encourage merger and consolidation, discriminatory income tax in favour of public quoted companies and aggressive enlightenment programme to increase awareness of the benefits of investing in the stock market and seeking quotation at the stock exchange.
4. Lastly, to boost the value of transactions in the Nigerian Capital market, there is need for availability of more investment instruments such as derivatives, convertibles, futures, swaps, options in the market. From the forgoing, it is seen that the Nigeria Capital Market can no doubt stimulate local investment in Nigeria if the recommendations given above are looked into and meticulously implemented by the authority of the Nigeria Stock Exchange, who midwifes the Nigeria Capital market.

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