Impact of Capital Market On Economic Development and Growth

Peters, S.O., Dairo, O.L. & Shorinmade, A.G.
D.S Adegbenro ICT Polytechnics
Itori, Ewekoro, Ogun-State, Nigeria
E-mails: samipeters1@yahoo.com; luqmansheik2005@gmail.com; wolexsho@gmail.com

ABSTRACT

The study evaluates the impact of capital market on the development and growth of the economy. The capital market is a network of financial institutions and infrastructure that interact to mobilize and allocate long-term funds in the economy. The market affords business organizations and government the opportunity to sell stocks and bonds, raise long term funds from the savings of other economic agents. The study was restricted to Nigeria stock exchange and aims at exploring the contribution of the capital market in the economy, also to evaluate the performance of the capital in relations to economy growth. The study employed a correlation cross-sectional survey research. Based on the result of the findings it shows that the capital market has a significant effect on the performance of market recapitalization.

Keywords: Capital Market, Economy Development, Economic Growth.

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1. INTRODUCTION

The capital market is a network of financial institutions and infrastructure that interact to mobilize and allocate long-term funds in the economy. The market affords business firms and governments the opportunity to sell stocks and bonds, to raise long-term funds from the savings of other economic agents. The sourcing of long-term finance through the capital market is essential for self-sustained economic growth, which is consistent with external adjustment and rapid economic growth. Success in capital accumulation and mobilization for development varies among nations, but it is largely dependent on domestic savings and inflows of foreign capital. Therefore, to arrest the menace of the current economic downturn, effort must be geared towards effective resources mobilization. It is in realization of this that consideration is given to measure for the development of capital market as an institution for the mobilization of finance from the surplus sectors to the deficit sectors.

The development of capital market in Nigeria, as it is in other developing countries has been induced by the government. Though prior to the establishment of stock market in Nigeria, there existed some less formal market arrangements for the operation of capital market. It was not prominent until the visit of Mr. J. B. Lobynesion in 1959, on the invitation of the Federal government, to advice on the role the Central Bank could play in the development of local money and capital market. As a follow-up to this, the government commissioned and a set up the Barback Committee to study and make recommendations on the ways and means of establishing a stock market in Nigeria as a formal capital market.

Acting on the recommendation of the committee, the Lagos Stock Exchange (as it was called then) was set-up in March 1960, and in September 1961, it was incorporated under Section 2 cap 37, through the collaborative effort of Central Bank of Nigeria, the Business Community and Industrial Development Bank. With the establishment of the Central Bank of Nigeria in 1959 and the coming into existence of the Lagos Stock Exchange in 1961 and Subsequently, the Nigeria Stock Exchange by an Act in 1979, a sound foundation was laid for the operation of the Nigerian Capital Market for trading in securities of long term nature needed for the financing of the industrial sector and the economy at large. After the incorporation of the Lagos Stock Exchange, it was granted further protection under the law and its activities was placed under some sort of control by the government, hence the passing of the Lagos Stock Exchange Act.

However, the Lagos Stock Exchange was only operational in Lagos. By the mid 70's, the need for an efficient financial system for the whole nation was emphasized, and a review by the government of the operations of the Lagos Stock Exchange market was advocated. The review was carried out to take care of the low capital formation, the huge amount of currency in circulation which was held outside the banking system, the unsatisfactory demarcation between the operation of Commercial Banks and the emerging class of the Merchant Banks, and the extremely shallow depth of the capital.

In response to the problems mentioned above, the government accepted the principle of decentralization but opted for a National Stock Exchange, which have branches in different parts of the country. On December 2nd 1977, the memorandum and article of association creating the Lagos Stock Exchange was transformed into the Nigerian Stock Exchange, with branches in Lagos, Kaduna, Port-Harcourt, Yola and now in Federal Capital Territory (FCT) Abuja some other cities.

1.1 Statement of the Problem

The business sector has depended mainly on short-term financing such as overdrafts to finance even long-term capital. Based on the maturity matching concept, such financing is risky. All such firms need to raise an appropriate mix of short- and long-term capital. There is abundant evidence that most Nigerian businesses lack long-term capital. Most recent literatures on the Nigeria capital market have recognized the tremendous performance the market has recorded in recent times. However, the vital role of the capital market in economic growth and development has not been empirically investigated thereby creating a research gap in this area.

1.2 Aim and Objectives of the Study

This study is undertaken to examine the contribution of the capital market in the Nigerian economic growth and development, with the main aim of examining the impact on Nigerian economic growth.
Other specific objectives include:

1. To explore the contribution of capital market in Nigerian economy.
2. To evaluate the performance of the capital market in relation to the economic growth of Nigeria.
3. To know the relationship between capital market and Nigerian economic growth.
4. To examine the role of capital market on source of finance for the government and industries.

1.3 Significance of the Study

The study explored the effectiveness of capital market on Nigerian economic growth.

Foreign investors, Corporate bodies, small and medium scale enterprises as well as individual investors who intend to explore the Nigerian Capital market will definitely find this research work relevant and useful in charting a new course in their endeavor to either raise fund or invest in the Nigerian capital market. The government will equally benefit from this research work in the area of policy guide on the performance of Nigeria capital market with a view to enhancing the economy.

The main importance of this study is that it will provide policy recommendations to policy-makers on ways to improve operations and activities of the capital market. This work would also be useful to students, scholars and researchers who may wish to undertake a similar study as they will use it as springboard for their personal work.

1.4 Scope of the Study

This study is centered on Nigerian Stock Market to look into the impact of capital market on Nigerian economic growth.

1.5 Limitations to the Study

This research like any other research is bond to have limitations, part of which includes:

1. Time constraint: The researcher will be faced with the problem of time constraint.
2. Financial constraints: In developing a project, there is need for financial involvement and looking at the present situation of the economy of the country, money is not easy to come by. The Researcher will have to download materials/journal from the internet, printing photocopying and transportation cost to the study area is also important for any project work to be carried out successfully.
3. The unwillingness by some respondents: Some respondent are always very reluctant to divulge data bothering on these issues for competitive or personal reasons.

2. LITERATURE REVIEW

2.1 The Financial Market

Financial Markets according to Amadeo (2013) is simply the markets where stocks, bonds, commodities, foreign exchange and even derivatives are traded to raise cash for government or businesses, reducing companies' risks and increasing investors' wealth. The financial market is the avenue through which funds are generated, mobilized and availed effectively and efficiently from the all-savers camps to the users of funds. These activities involve the interplay of individuals, institutions and instruments. Financial instruments owned by individuals in different institutions to provide the needed finance for the provision of essential goods and services to bring about economic growth and development. The Financial market according to consists of two major segments, the money market and the capital market. The money market provides finance on short-term basis to individuals while the capital market provides finance to businesses, enterprises, corporate bodies, government agencies etc.

2.2 Concept of the Capital Market

Capital Market has been described by Akigbohunde (2006) as a market where medium and long term finances are raised. Ekezie (2012) revealed that it is a market for dealings (i.e lending and borrowing) in long term loanable funds. The development of capital market and apparently the stock market provides opportunities for greater fund mobilization, improves efficiency in resource allocation and provision of relevant information for appraisal (Inanga and Chiedozie 2007). Al-faki (2006) argues that capital market is a network of specialized financial institutions with series of mechanism, processes and infrastructures that in various ways facilitate the bringing together of suppliers and users of medium to long term capital for investment and economic development projects.

The capital market is the complex of institution and mechanisms through which economic units desirous to invest their surplus fund, interact directly or through financial intermediaries with those who wish to procure funds for their businesses. Okereke and Onyieke (2010) describes the capital market as constituting of market and institutions that facilitates the issuance and secondary trading of long-term financial instruments. Unlike the money market that represents the short-end of financial system that provides facilities for claims and obligations with maturity vary from one day to a year, the capital market provides government at all levels an effective way of financing public projects; thus playing a vital role in stimulating industrial as well as economic growth and development.

However, the Nigerian financial markets are experiencing challenges such as poor infrastructural facilities, low level of public awareness as to the benefits derivable from the operation of the capital market, inadequacy of supply of securities, stringent stock exchange listing requirements limiting mostly the smaller companies, illiquid market and unfavorable government policies.

2.2.1 Structure of the Nigerian Capital Market

The capital market operations are structured into three broad categories: the primary, secondary and derivatives markets.

The Primary Market: it is responsible for the issue of new shares through the stock exchange or by private placement. Their operations are conducted through the following methods: offer for subscription, offer for sale, right issue, private placing and listing by introduction.

The Secondary Market: also referred to as the stock market, it provides the forum for capital market activities (trading in stock and shares, bonds, debentures and other long-term securities) and is usually accessible to all category of investors – small or big, government institution or individuals. The major participant in the Nigerian capital market includes development banks, private firms, the treasury and the CBN while the minor ones includes commercial and merchant banks, individuals, states and local governments.

The Derivatives Market: This is the market that trades on the right to title on the underlying security or on the basis of the future title to the security. The derivatives market in Nigeria is still in its infancy and the only derivative presently being actively traded on the Nigerian Stock Exchange is right offer issue options.

2-2.2 Development of Capital Market

There has been considerable interest in the development of capital markets in many developing countries in the last forty years or so. Relative to Nigeria, Atoyebi, Ishola, Kadiri, Adekunjo and Ogundeji (2013) study the impact of capital market on economic growth using annual data of 1981 to 2010. Employing the Ordinary Least Square test and Vector Auto Regression technique, a percentage increase in market index and market capitalization was found to bring about respectively, an average of 33.7% and 44.8% increase in real GDP. Kolapo and Adaramola (2012), applying Johansen co-integration and Granger causality tests, also examined the impact of the Nigerian capital market on its economic growth but from 1990 to 2010.

Results show that a long run relationship exists between capital market (measured by market capitalization, total new issues, value of transactions, and total listed equities and government stocks) and economic growth (proxy by GDP) in Nigeria. The evidences from these studies reveal that the activities of the capital market tend to impact positively on the Nigerian economy. Similarly, Abu (2009) utilized the error correction approach to examine whether stock market development increases economic growth in Nigeria and it was found to be true

2.2.3 Roles of Capital Market on Economic Growth and Development

Osaze (2010) sees the capital market as the driver of any economy to growth and development because it is essential for the long term 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 of diversification, savings mobilization and corporate control (Anyanwu 2008). Therefore, by altering the quality of these services, the functioning of stock markets can alter the rate of economic growth (Equakun 2015).

Okereke- Onyiuke (2010) 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.

Sule and Momoh (2009) founded 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 as observed by Aremu. (2011) includes:

- It provides opportunities for companies to borrow funds needed for long-term investment purposes.
- 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.
- It provides a means of allocating the nations real and financial resources between various industries and companies
- 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.

2.2.4 Problems facing the Nigerian Capital Market

The Nigerian capital market, like the national economy, has been faced with many problems. These problems are both endogenous and exogenous. The exogenous problems are those outside the direct control of the market but which are regulation-induced. The endogenous problems are those that are internal to the market but which are amenable to changes with improved operational procedures including the adoption of information technology. Some of these problems are discussed below:

1. **Small Size of the Market:** Among the major problems facing the Nigerian capital market is the size of the market. At about 200 quoted companies and a market capitalization of over 3.1 billion at the end-December, 2014 the size of the market is considered to be small when compared with stock market in other emerging markets.
2. **Problem of Illiquidity of the Market:** The liquidity of a stock market relates to the degree of access, which investors have in buying, and selling of stocks in such a market. The more liquid a stock market is, the more investors will be interested in trading in the market. The lack of adequate number of investors in the Nigerian stock market is a reflection of problem of illiquidity in the market.

3. **Growth of Securities Market:** Lack of cooperation between the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) has been responsible for slow growth of the securities market.
4. **Transaction cost in the Nigerian capital market is enormous**: The costs which an average investor would have to meet in the course of raising funds include; brokerage fees; stamp duties, and other charges that may be imposed by the SEC, apart from other fees payable to stockbrokers. Therefore, the cost of going public, raising additional equity or obtaining loan facility from the capital market is high.
5. **Delay in Delivery of Share Certificates:** The delay in delivery of share certificates to investors and intra-firm settlements used was a problem in the market. Many of the unclaimed certificates and dividend warrants that are being published regularly are as a result of the delay in delivery of certificates.
6. **Double Taxation:** The Nigerian stock market is faced with the problem of double taxation. In a capital market, the operating tax policies have implications for the supply and demand for financial assets. Depending on its nature and structure, taxation could either enhance or retard capital market growth. Tax can be a source of hindrance to development when it is high or levied at multiple stages.

2.3 Theoretical Review

Capital Market Theory

Forty years have passed since the principles of classical economics were first applied formally to finance through the contributions of Fama in 1970 and his now-renowned fellow academics. Over the intervening years, capital market theory and the efficient market hypothesis have been developed and modified to form an elegant and comprehensive framework for understanding asset pricing and risk. But events have dealt a cruel blow to these theories, as John Authers argued capital market booms and crashes, culminating in the latest sorry and socially costly crisis, have discredited the idea that markets are efficient and that prices reflect fair value. Some economists still insist these events are simply the lively interplay of broadly efficient markets and see no cause to abandon the prevailing wisdom. Other commentators, including a number of leading economists, have proclaimed the death of mainstream finance theory and all that goes with it, especially the efficient market hypothesis, rational expectations, and mathematical modeling.

2.4 Empirical Review

Nwokoma (2012), attempts to establish a long-run relationship between the stock market and some of macroeconomic indicators. His result shows that only industrial production and level of interest rates, as represented by the 3-month commercial bank deposit rate have a long-run relationship with the stock market. He also found that the Nigeria market responds more to its past prices than changes in the macroeconomic variables in the short run. Adam and Sanni (2005) examined the role of stock market in Nigeria's economic growth using Granger-Causality test and regression analysis. The authors discovered a one-way causality between GDP growth and market capitalization and a two-way causality between GDP growth and market turnover. They also observed a positive and significant relationship between GDP growth turnover ratios. The authors advised that government should encourage the development of the capital market since it has a positive relationship with economic growth.

Elumilade and Asaolu (2006) examine the relationships between stock market capitalization rate and interest rate. Time series data obtained for the period 1981-2000from Central Bank of Nigeria (CBN) and Nigeria Stock Exchange (NSE) were analyzed using regression. The data obtained were fitted to the equation by ordinary least-square (OLS) regression method. Results showed that the prevailing interest rate exerts positive influence on stock market capitalization rate. Government development stock rate exerts negative influence on stock market capitalization rate and prevailing interest rate exerts negative influence on government development stock rate. The impact of stock market earnings on income of the average Nigerian using time series data covering the period 1980-2007.

Applying co-integration and error correction modeling to stock market performance and per capital income time series data, the findings indicated the separate roles played by the primary capital market and the secondary capital in market in the growth of stock market earnings that has impacted positively on Nigerian per capita income. By and large, the evidence from this study revealed that while activities in the secondary capital market tend to grow the stock market earnings through its wealth effect that of the primary market ironically did not.

3. METHODOLOGY

Research methodology requires gathering of relevant data from specified documents and compiling data base in order to analyze the materials and arrive at a reasonable conclusion of the selected study. The specification of procedure for collecting and analyzing the data necessary to help solve the problem at hand such that the differences in the cost of obtaining various level of accuracy and the expected value of the information associated with each level of accuracy is measured. This study was basically a survey and a case study research and therefore requires the use of survey and case study method of investigation.

In this research, annual report was used to gather information relevant to this study. Sampling techniques used are the statistical analysis in which a predetermined number of observations will be taken from a large population. The sampling techniques adopted was simple random technique. The data obtained from the published financial statement of sampled techniques (within the study period) were analysed using linear regression analysis (ordinary least square method) from E-view for the purpose of hypothesis testing.

4. DISCUSSION OF FINDINGS

The study assess the impact of capital market on economic growth in Nigeria, using annual time series for the period of 2014 - 2017. To achieve this objective, an error correction model was estimated for economic growth using Vector Error Correction techniques. It was revealed that market capitalization total value of listed securities, labor force participation rate, accumulated savings and capital formation are significant macroeconomic determinants factors of economic growth in Nigeria within the scope covered. Findings from the study are consistent with previous studies as the result of the normalized co-integrated relationship reveals a significant relationship between market capitalization, savings deposit, gross fixed capital formation, labor force, total listed asset and real economic growth; with market capitalization, savings deposit and capital accumulation having a direct effect on economic growth in Nigeria. This signifies that higher stock market capitalization increases the ability of firms to raise capital in order to increase investment spending and expand production of goods and services and this translates to higher growth rate in the long run.

5. CONCLUSION

This study examined the contribution of capital market to economic growth and it was found to be positive. This suggests that for a significant growth to be achieved in an economy, the main focus of policy makers should be on measures to promote growth in the stock market. This is a very pertinent and prerequisite consideration for any economy desiring increase rapid economic growth. The use of some notable capital market development indicators, the relationship between capital market development and economic growth was found to be positive. The study therefore shows openness and gross capital formation was effective in capital formation and instrumental to economic growth and development of Nigeria. The study therefore concludes that the Nigerian capital market promotes economic growth is not in doubt.

6. RECOMMENDATIONS

The findings from this study raise the following policy issues and recommendations.

i. In order to enhance the development of the Nigerian capital market as the engine of economic growth, it is recommended that government should remove impediments to stock market development in the form of tax, legal and regulatory barriers because they are sometimes disincentives to investment.
ii. In order to increase the ease with which investors can purchase and sell shares, thus guaranteeing liquidity on the stock market, the Nigerian Security and Exchange Commission should improve on the trading system.
iii. Given that the stock market operate in a macroeconomic environment, it is therefore necessary that the environment must be an enabling one that will promote and encourage investment opportunities for local and international investors.
iv. To significantly enhance labor force participation especially in capital market activities, more priority should be accorded to human capital development through more educational funding, scholarship programmes and educational grants.
v. Other programmes such as vocational training and skill acquisition could also be built into the educational system to improve on the quality of labor force and professionals.
vi. The value of the total traded securities and equities revealed no direct relationship with economic growth indicator-gross domestic product growth rate. This suggests that companies listed on the Stock Exchange should be mandated to provide timely electronic information on their operations such as quarterly and annual financial statements, in order to enable the market learn, absorb and act on information quickly leading to market efficiency and precise pricing of securities.
vii. With the existence of a positive relationship between stock market development and economic growth, it is pertinent to recommend that there should be sustained effort to stimulate productivity in both the public and private sectors.
viii. The Nigerian government should employ appropriate trade policies that promote the inflow of international capital and foreign investment, so as to enhance the production capacity of the nation.
ix. Capital Market regulators especially the Securities and Exchange Commission should be more open to innovations and be flexible without jeopardizing the interest and protection of investors as well as the efficiency of the market.
x. The Commission needs to encourage more companies to be listed in the market so as to expand it and give investors better options for investment. Recent experience has shown that the confidence of many shareholders is waning due to the declining fortune of the stock market and many are reluctant to invest in shares and other securities

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