

*Full Length Research Paper*

# Capital market as a veritable source of development in Nigeria economy

Josiah Mary<sup>1\*</sup>, Samson. A. Adedinran<sup>1</sup> and Akpeti. O. Elizabeth<sup>2</sup>.

<sup>1</sup>Department of Accounting, College of Business Management Science, Igbinedion University Okada, Edo State, Nigeria.

<sup>2</sup>Department of Business Administration, College of Business Management Science, Igbinedion University Okada, Edo State, Nigeria.

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**This study takes a look at the impact of the capital market in the development of the Nigerian economy. The main objective includes; identifying the importance of the capital market. Data were collected from the Central Bank Statistical Bulletin from the period of 1992 to 2007 and the Ordinary Least Square and cochrane – Orcutt iterative methods were used to analyze the data. It was discovered that the capital market has not contributed positively to the development of the Nigerian economy. However, there is a positive correlation between the rate of transactions in the capital market and the development of Nigerian economy. It is recommended that stringent requirement for entry into the capital market should be relaxed and adequate publicity should be given to the activity at the capital market, it is believed that when these recommendations are implemented, the impact of capital market on the economy will be positive.**

**Key word:** Capital market, economy, development.

## INTRODUCTION

The capital market is the prime motor that drives any economy on its path to growth and development because it is responsible for long-term-growth capital formation. The money market only complements the capital market by providing the necessary working capital to support gross fixed capital formation. Unfortunately, the Nigerian capital market has not fully performed its natural function of funding investment. One of the major indicators of capital market development is the proportion of long-term fixed capital that is raise in relation to the gross domestic product. Between 1999 and 2004, capital formation in terms of long-term funds raised from the market through new issues of securities to the gross domestic product averages only 1.36%, while the new issues to gross fixed capital formation averages 16.0%. Market capitalization to gross domestic product also averaged only 14.25% during the same period. It is therefore not surprising that the Nigerian economy has only been growing at an

average of 3.2% annum over the period. Most of the funds raised in Nigeria have been short-term from the money market and these are not growth funds. According to Mary et al. (2012). Financial institutions have not contributed much in financing capital investment but they have however contributed towards stock market development.

The capital market has not been a popular source of funds because of the instability in the economy, low yields to investors in capital market instruments, and government's overbearing presence in economic matters.

## Objectives of the study

- 1) To provide special financing strategies for those projects with long-term gestation periods.
- 2) To create an appropriate mechanism for capital formation and efficient allocation of resources among competing projects.
- 3) To broaden share ownership practice and maintain fair prices for securities.

\*Corresponding author. E-mail: [majoel2003@yahoo.com](mailto:majoel2003@yahoo.com)

## LITERATURE REVIEW

Capital market has important strategic roles for providing risk capital for long term structures that ensures the liquidity and stability of financial system. Thriving capital markets are often vibrant in private sector development and strong economic growth.

Within the broad classifications of capital market are the security market and non security market. The non security, which comprises of bank and bank related institutions mainly intermediate indebt and debt related instruments. This type of financial market institution performs mostly financial intermediation and is quite developed relative to the security market.

### The capital market

One of the widely quoted definitions of the capital market is given by Nwankwo (1998: 246) who says that the capital market comprises the complex of institution and mechanism through which intermediate term funds and long term funds are pooled and made available to business, government and individual. They also asserted that the capital market comprises the process by which securities already outstanding are transferred. This definition is very embracing; it contains the fact that the capital market has no fixed location and deals on medium and long term funds, has government, individual and business firms as participants and ensures liquidity as it provides market for both new and old securities.

Also according to Alile (1986:154), the central task of the capital market is the mobilization of funds in the hands of individuals who save pool and channel such funds into productive uses.

### Capital market instruments

The instruments are the securities that are traded in the stock market. They cannot be inspected or assessed the way electronics, tubers, apples, grapes etc are being assessed. The instruments can be categorized into three major groups of securities according to Herbert (2004:421). These are;

- a) Ordinary shares
- b) Preference shares
- c) Debt instruments

**Ordinary shares:** They are issued to owners of the company. They are long term financing with a nominal value or face value. The memorandum and article of association of a company specified the number of authorized ordinary shares a company can issue. The ordinary shareholders of a company have a residual claim in the company, their claims to income and assets

come after the creditors and preference shareholders have been paid in full. As a result, a shareholders return on investment is less than the return to a lender or preference shareholders. However, there is no limit to the return of ordinary shares.

**Preference shares:** This is another major source of long-term financing to a company. The holders of preference shares are entitled to a fixed percentage dividend before any dividend is paid to ordinary shareholders. However, preference dividend can only be paid if sufficient distributable profits are available, although with cumulative preference shares the right to an unpaid dividend is carried forward to later years. The arrears of dividend on cumulative preference shares must be paid before any dividend is paid to ordinary shares. For credibility sake, companies always try to pay the fixed dividend regularly.

Just like the debt instruments, a preference shares has a nominal value and dividend, which is paid at a fixed percentage of this amount. Preference shares can be redeemable or irredeemable.

**Debt instrument:** A bond represents a method of long term borrowing by corporation of government agencies, when a corporate bond is issued, it as a legal contract that goes with it which contains the provision of loans in terms of its amounts, interest and maturity period. Bonds are sold in multiples such as N1000. They are purchased by commercial banks, insurance companies, pension fund and even individuals. This form of financing is usually reserved for target companies or corporation. This is why they have prior claims on the firm's asset in the event of liquidating. There are different classes of bonds

### Types of capital market

#### Primary market

According to Soyede (2005: 8) Primary market is a market for new securities. It is a platform where the company or government can raise money for investment or where already quoted companies can raise fresh funds for expansion. Both the Securities and Exchange Commission (SEC) and the Nigerian Stock Exchange (NSE) are involved in primary market activities. The issuing houses and stock brokers also play prominent roles. Until 1993, when deregulation of the capital market commenced, the SEC was responsible for pricing and allotment of new issues in the Nigerian capital market while the quotation committee of the Nigerian Stock Exchange approved only issue which is to be listed on the exchange's official list. The issuing houses and stockbrokers package issues for government and public companies.

However, the Central Bank of Nigeria acts as issuing

houses for federal government stocks when company wishes to sell such shares (offer for sale). If such company is already listed, the price is technically suspended to forestall any insider or abuse of classified information. This situation holds true reason for companies going into mergers and acquisition or rearrangement that may potentially have bearing on their price and the suspension is sustained by the Nigerian Stock Exchange until such exercise is completed.

For companies seeking listing for first time, the securities are listed with the offer price; soon after the offer exercise is completed instruments representing ownership are dispatched to the shareholders. It is of paramount important to mention here that hitherto, Securities and Exchange Commission was the sole body giving approval to offer price proposed by the Issuer in conjunction with Issuing Houses. However, under the present dispensation the issuing house proposes and defends a price at which it is willing to underwrite the entire securities to be issued. This becomes the offer price and entirely conforms to the price. While Securities and Exchange Commission examines the offer documents with a view to ascertaining the adequacy of price and conformity with statutory requirements among other things, the Nigerian Stock Exchange reviews the same documents to ensure the company or institution meets its listing requirements.

According to Alile (1997: 109) The primary market takes into representation the issuance which could be in form of any of the following:

**Offer for sale:** Public offers for shares in a company by existing shareholders, proceeds of which go to the vendors. This is a system by which existing shareholders offer their shareholding or part of them for public subscription. In other words, offer for sale is a transfer of ownership of shares from existing holders to new holders. Most of the public offers under the federal government privatization programmer under this category. It differs from offer for subscription in that the proceeds of an offer do not go to the company but to the selling shareholders.

**Offer for subscription:** This is a direct issue to the public by floating a number of shares of debenture stock. It carries the suppositions that the company is a public one and the proceeds of the issue go to the company to finance expansion or and modernization. In other words, the company issues a prospectus inviting the public to its shares and it should be noted that the company cannot dictate who subscribes to its shares.

**Stock exchange introduction:** Where a company seeking quotation already has enough shares held in public hands, the council of stock exchange may permit its security to be introduced into and listed on the market, no new or existing shares to be sold. The added marketability to raise fresh funds in the future invariably

at a lower price or cost.

**Private placement:** Securities are sold to the client of the Issuing Houses or Stockbrokers handling the issue instead of being offered directly to the general public. This is often necessitated by the desire to save time and cost of issue. The council of the Stock Exchange seldom grants such permission and this method is utilized by quoted Plc's. This differs from offer from the subscription and offer for sale in that it is not an invitation to the public to subscribe, rather, the shares or stocks are placed with a broker who then seeks out for the prospective purchasers.

**Right issue:** These involve offer to buy more shares generally made to existing shareholders and sometimes at concessionary price. Applications are considered by quotations committee of the exchange for ratification and avoid excruciating interest rate charged in the money market. The approval of the council gives the go ahead for the primary market activities before the commencement of the primary market activities; the Securities and Exchange Commission is given the application to determine the offer price of the security.

However, in view of favourable terms on which such issues are usually made, shareholders scarcely ever miss the opportunity. Underwriting of securities is an aspect of primary market. It is an intermediary process and it is far gaining ground in Nigerian Capital Market. They buy from the issuers at one and sell to the investors at a slightly higher price. The price differences referred to as "underwriters spread", represents compensation for absorbing the risk that goes along with guaranteeing the borrower, the expected proceed from sales before the securities are actually placed in the market or in hand of investors.

### **Secondary market**

This enhances the new issue market in many ways, it provides the means by which investor can monitor the value of their shares and liquidate them when they wish to do so. According to Pandey (2006:4), it is a type of market where existing securities of a market are traded on daily and continuous basis. It is the market for existing securities. This consists of exchanges and over-the-counter markets where securities are bought and sold after their issuance in the primary market. It has little to do with influencing the way an economy allocates its capital resources or the way in which sailing surplus and savings deficit unit deal with one another. However, events in the secondary market frequently provide the basis for the terms and conditions that will prevail in the primary market. If there were no secondary market in which investors could turn investments in new issues

back into cash when they choose, many investors would not buy new issues in first places. If any investors truly intend to make any irrevocable commitment of their funds, the availability of a secondary market is an absolute pre-requisite to the existence of a primary market in common stock. From the perspective of the overall economy, the secondary augmentation of the flow of funds into the new issue market is particularly important. It makes it possible for the economy to make long term commitment in real capital. This point is perhaps best illustrated by considering what would occur if the financial claims issued by firms and individuals could not be traded in the secondary market. The secondary market makes it possible for those who desire to make long term real investments to obtain the money capital of savers who have no intension of committing themselves for the long term. Thus, they provide the economy with the opportunity to consider entirely new approaches to building its capital stock. Market capitalization is the market value of a company's issued shares capital; it is the product of the current quoted prices of shares and the number of shares outstanding.

### **Opportunities in the capital market**

According to Dozie (1996: 11) the capital market can be described as a place where a nation's wealth is bought and sold. It creates facilities for raising funds for investment in long term assets. The Nigerian capital market is no exception to this global role. The opportunities that abound in our market can be looked at from three major perspectives.

### **Corporate finance benefits of the capital market**

A unique benefit of stock market to corporate entities is the provision of long term, non-debt financial capital. Through the issuance of equity securities, companies acquire perpetual capital for development. Through the provision of equity capital the market enables companies to avoid over reliance on debt financing. Thus improving corporate debt to equity ratio.

### **Financing options in the capital market**

The stock market offers an array of financing instruments that the long term investments that meets the long term investment needs of both government and private sector. The medium and long term corporate debt markets remain a critical element in the sustainable development of economics. Experience in Nigeria in the last decade, shows that the use of corporate bonds is a more prudent method of raising long term finance than bank loans. The advantages are that states or local government can implement their project quickly and at the same time avoid high interest rates in the bank loans.

### **Secondary market activities**

The stock market is an important economic sector whose uses are best appreciated from the perspective of efficiency in capital formation and allocation. An efficient stock market mobilizes savings and allocates a greater proportion to those investments with the highest perspective rate of returns after giving due allowance for risk. Secondary market is synonymous with the NSE and does not create new securities.

The business in this market is triggered off when investors in the primary market decide to dispose their holdings. In effect, the issuing companies do not directly benefit from transactions in the secondary market. It is the original investors that benefits. Such benefits come in form of Okigbo (1981:1);

- a) Dividend payment.
- b) Stock splits.
- C) Capital appreciation.
- d) Long term hedge against trends.

### **ENVIRONMENTAL IMPERATIVES FOR CAPITAL MARKET SMOOTH FUNCTIONING**

Before the objectives of capital market can be fully achieved for economic growth of any nation, the following environmental factors are imperative for its smooth functioning;

- a) An economic and administrative central structure cum policy measures that allow an appropriate role for private sector enterprises: This refers to the encouragements and public enlightenments made to the members of the public or benefits to be derived by investing their savings in capital market and all other steps to boost development for the betterment of a nation.
- b) A policy scheme that encourages price flexibility as reflected by the interplay of supply and demand factors. This is the work of the regulatory bodies like Nigerian Stock Exchange (NSE), Security and Exchange commission (SEC) and government can come up with any measures for its growth if the need arises.
- c) A stable political environment: frequents changes of government and their policies cum decisions without due consideration of the importance of capital market will not augur well for development. Therefore a well defined and articulated programme coupled with a stable and organized political environment will have a positive effect on the activities and growth of capital market.

### **Conditions for establishing a capital market**

According to Ekiran (1999: 267) the environment of a country plays a major role in the success or failure of a capital market development because if an environment is conducive, it will give room for the rapid growth of a

capital market than in an environment that is hostile.

### ***Political environment***

This is the first to be considered in establishment of capital market. If there is enough political stability, it gives the investors' confidence that national policies will permit over time and that these policies will appropriate measures to encourage private savings of both the entrepreneurs and the investors. But in an unstable short term view, this causes a volatile market and does not encourage long term planning.

### ***Economic environment***

In an economy where market development becomes priority, government enterprise should not be pre dominant, otherwise capital market development becomes difficult.

### ***Role of private sector***

The role of a stock market within an economy as an engine for capital formation is intentioned with findings and positive constructive role for the private sector in general. To achieve this, both the private sector and the capital market must be integrated into the country's overall development programme, both must know and be responsive to the needs of the population as a whole. In addition, microeconomics measures such as risk, yield and liquidity of capital must be adopted to encourage the greater channeling of saving through capital market.

### ***Legal and regulatory environment***

Regulation is necessary to protect the investors and in process increase their confidence. It is also necessary to ensure a fair and orderly security in the market to achieve these objectives, company laws must be modernized and the conditions granting the listing to companies seeking quotations must be clear and positive, there must be rules and regulations for the brokers, directors and also operators of the stock market. Also, there must be code of conduct for brokers, directors and managers of the stock exchange, stock broking firms and quoted companies.

### **Characteristics of capital market**

According to Ekiran (2000: 268) the characteristics of capital market include:

#### ***Participant***

The participants of capital market can broadly be

classified into regulators and the operators. The regulators include an apex regulatory body usually a securities commission and the securities exchange itself which is usually self regulatory. The operators which are sometimes referred to as issuing houses, regulatory etc.

### ***Commodities traded in the market***

The commodities traded in the market are securities of medium and long term nature.

### ***Scope and size***

The scope and size of a capital markets are quite large and wide. The market thrive on movement of activities and dealing.

### ***Organization***

Most capital market though wide in scope are normally organized. This is necessary in order for them to command the respect of the public and at the same time guarantee a fair play to all the participants.

### ***Flexibility and adaptability***

One way by which the effectiveness of a capital market can be measured to examine its readiness to accept and take part in changes that may occur in the overall economy.

### ***Mode of transaction***

Transaction in the capital market involves the use of financial instruments such as corporate equities (shares), debentures, government bonds etc all in an effort to raise funds.

### ***Duality on the transfer process***

This feature is based on the fact that the capital market performs the dual role of raising funds through the issue of new instruments or selling existing ones to new investors. By this function, the market helps to ratio funds among numerous competing alternative uses.

## **ROLE OF CAPITAL MARKET**

The main function of the capital market is to transfer from surplus (savings) sectors to the deficit (capital investment) sector of economy. Hence, we say that the

capital market enables or facilitates the transfer of funds from savers to users.

The various institutions which facilitate the transfer of funds in the capital market includes; stock exchange, issuing houses, stock brokers, shareholders, share distribution agents (commercial banks), underwriters and institutional investors (e.g. pension funds, insurance companies and merchant banks) and the Nigerian Securities and Exchange Commission as the apex regulatory body.

According to Muhammed (1988: 10) the function of an active market includes the followings:

- a) The promotion of rapid formation.
- b) The provision of sufficient liquidity for any investor or group of investors.
- c) The mobilization of savings from numerous economic units for economic growth and development.
- d) The provision of an alternative source of fund other than taxation for government.
- e) The creation of a built in operational and creational efficiency within the financial system to ensure that resources are optimally utilized at relatively little costs.
- f) The encouragement of a more efficient allocation of new investment through the pricing mechanism.
- g) The broadening of the ownership base of asset and the creation of healthy private sector.
- H) Provision of an efficient mechanism for the allocation of savings among competing productive investment projects.
- i) The encouragement of a more efficient allocation of a given amount of tangible wealth through changes in wealth ownership and composition.
- j) It is an avenue for effecting payment on debt.
- k) It is a necessary liquidity mechanism for investors through a formal debt and equity mechanism.
- l) It is machinery for mobilizing long term financial resources for industrial development.

### **LEVELS OF MARKET EFFICIENCY**

A market is said to be efficient if it uses the information available correctly in setting and adjusting prices of securities. Inoga (1977: 24). Market efficiency refers to two essential ingredients of price adjustment to new information. Speed and quality (direction and magnitude) of the adjustment. The main effect of efficiency in capital market is that it precludes most investors from the capacity or ability to out-perform the market. But the market is deficient in terms of speed and quality of its reaction, the sophisticated investors would have little difficulty in profiting from the situation.

Alile (1997: 105) and Pandel (2006: 419) made a distinction between three levels of market efficiency with each level relating to a specific set of information which is increasingly more comprehensive than the previous level. These are weak, semi strong and strong levels of

efficiency.

### **Weak efficiency**

A market is efficient in the weak form if share prices fully reflect the information implied by all prior price movements. Share price movements become totally independent of previous price movement implying the absence of any price pattern with prophetic significance. Prices would only respond to new information such as a new economic event or new industry.

The implication of this is that historical price and returns information does not provide a basis for superior forecasting of future price or returns. Therefore past information cannot help investors beat the market and make excessive returns.

### **Semi strong efficiency**

This is efficient in the semi strong sense if share prices respond instantaneously and unbiased to new published information. The implication of semi strong efficiency is that current share prices would invariably represent the best interpretation of the information about the firm. Therefore, it becomes futile for investors to search for bargain opportunities from analysis of published data, such as annual reports or other corporate announcements designed to lure them to the market.

### **Strong efficiency**

The market is efficient in the strong form if share prices fully reflect not only published information but also all relevant information including data not yet publicly available.

To conclude the review on the efficient capital market theory, it can be asserted that if prices and returns prevailing at any point in the capital market do reflect all available historic and current public information, it will be difficult for investors to achieve superior performance by judging that security market conditions may be better or worse in the future.

### **CAPITAL MARKET AND ECONOMY DEVELOPMENT**

Economic development according to Kindler Berger means improvement in Nigeria welfare especially for persons with the lower incomes, the eradication of mass poverty, illiteracy, disease and early death, changes in the composition of input and output that include shift in the underlying structure of production away from agriculture towards industrial activities, the organization of the economy in such a way that productive employment is generally among the working age population

rather than the situation of a privileged minority and the correspondence groups in making decisions about the direction, economic and otherwise in which they should move to improve their welfare.

Economic development involves a sustained growth in quality and quantity of the output over a period of time, thus leading to structural transformation of the economy.

This happens when store resources are saved from productive use and savings are channeled into the type of investment which will increase productive capacity. It is at this point that the facilities created by capital market come into play for the channeling of savings into investment.

Capital accumulation of formation, directions of flow as well as the mechanization and efficient utilization of capital are crucial to any economy. One of such mechanisms is the capital market. One might at this point ask the question "What is capital?"

According to Ekiran (2000: 253) capital is the portion of resources available to the current period which rather than being consumed, are being diverted to the creation of intermediate goods which in turn would be used in the production of other goods.

Alternatively capital may refer to those stock of finished goods produced at the current period but are put for further consumption. The essence of capital formation is therefore the postponement of consumption to some future date.

### **Development in the Nigerian capital market**

The finance and insurance sector is the one that has experience about the highest growth on the Nigeria economy especially since after the introduction of the Structural Adjustment Programme (SAP). This has had positive implications on the activities of the capital market in Nigeria.

The total number of securities transacted in the capital market (both first and second tier) was 334 in 1961. Of this, government securities were 92 while industries were 342 (72.5% of the total). In 1965, the total number of transaction increased to 1018 (204.79% over the 1961 figure). Of this, industrial securities dominated with a percentage share of 61.6%.

The number of transactions however dropped in 1970 to 643 (47.8% of which were government securities). Again, the value of total transactions in the year was N16.6 million with government securities accounting for almost the total value (98.78). Industrial securities though more in number were valued at only N0.2 million.

From 1976 however, industrial share of both in number and value of transactions increased tremendously (from 97.0 and 2.03% for 1990 to 97.3 and 3.29% for 1985 and 98.85 and 11.11% respectively in 1987).

The sudden growth both in the total number and value of transaction in the market and in the share of industrial

securities during these periods can be attributed to the positive effect of the Nigeria enterprise Promotion Decree of 1977 on the development of the private enterprise in Nigeria.

The same positive trend continued at even a faster rate in the late 1980's. The share of government securities in the number and value of transaction fall from 1.44% and 92.6, in 1985 to 1.15 and 88.9% respectively in 1987, falling further to 0.39 and 65.13% in 1990, 0.10 and 10.4% in 1993 and 1995. This development is in line with Structural Adjustment Programmes' policy of allowing greater private sector participation in the economy.

Unlike the above picture, the trend in the total number and value of securities traded in the capital market over the same period as being erratic with decline in number 1990 and 1993 and the value in 1985. Both the secondary and primary market recorded massive growth in 1995 as a result of the relative calm in industrial environment (compared with 1993 and 1994), the repealing of the Nigeria enterprise promotion (NEP) Decree and Exchange Countries Act (ECA) of 1962. Another development that aided positive growth in 1995 was the promulgation of the Nigerian Investment Promotion commission (NIPC) Decree No. 16 and the Foreign Exchange provision decree No. 17 of 1995.

The stock exchange began its operation on 6th June, with 8 securities listed on it. Activities in the year 2001 shows that exchange as 282 securities made up of 19 government stock / bond, 49 industrial loan (debentures) or preferences. Six companies were listed on this segment of the stock market by 1988 and by 2002 over twenty-three companies had availed themselves of the opportunities offered by this market.

Over the years, the listing has increased and as at November 30th, 1985 there were 20 securities on the exchange official list, and increasing to 290 as at the end of April 2007. Although a small market by international standard, the Nigerian capital market is one of the leading markets in Sub-Saharan Africa and has made some notable strides in recent years. With a history of over 50 years (when the first public issue was floated) and 42 years of a stock exchange, equity listings and market capitalization are still relatively small, standing at 196 and US\$7.0 billion respectively at the end of March 2003. The value of equities traded at year-end 2002 was US\$0.5 billion, a much lower figure than market capitalization. As a result of this, turnover ratio of 7.9% was recorded at the end of 2002, higher than the average turnover ratio for 1998 to 2002. From a historical perspective, this figure except for 2001 is an improvement, evidencing the continued rise in activities in the market. The market has been quite active this year with traded equities of N10.8 billion (US\$ 86 million) in January 2003, which represented about 18% of the total equity value in 2002. By end of March 2003, N24 billion (US\$188.9 million) equities had been traded. It is important to point out that the depreciation of the local currency, the naira,

has continued to impact on the size of the market in dollar terms. Between 1997 and December 2002, the naira lost over half its value to the dollar. As a result, while market capitalization witnessed impressive growth in local currency terms, this was not the case in dollar terms as a much slower growth was registered. For instance, in the five years ending 2002, equity market capitalization recorded almost three-fold increase from N256.8 billion in 1998 to N748.7 billion in 2002 or a 191.5% increase while it rose by 52.6% or from US\$3.8 billion in 1998 to US\$5.8 billion in 2002. The point being made is that, if the local currency had been strong, the dollar size of the market would have been larger.

In 2002, equity market capitalization grew by over N100 billion (US\$794million) or 15% and has remained on the upward swing this year. In the month of January 2003, equity market capitalization rose by over 12.4% and by February 2003, it had gained N116 billion (US\$0.9 billion) over December 2002 more than the increase in the whole of that year. However, in March 2003, market capitalization rose by N98.2 billion (US\$0.8 billion) over December 2002. If this trend continues, market capitalization by year-end 2003 is likely to significantly surpassing the gain recorded in 2002.

The impressive movement in market capitalization has been led principally, by new listings, and firmer prices arising from positive market sentiments. In 2004, the stock index rose by 10.7% albeit lower than the price increase of 35.2% in 2003 and 54.0% in 2000. In point of fact, the five years (2000 to 2005) average index growth of 33.3% was higher than the growth of inflation, which averaged 12.6% during the same period.

The impressive expansion of the capital market is also evident in the size (percentage) of market capitalization to gross domestic product (GDP). A look at this over the past decade shows that market capitalization represented 14.0% of GDP in 2002 in contrast to 12.0% in 2005, 9.4% in 1999 and 5.6% in 1992. The rising trend indicates that market capitalization is growing faster (in percentage terms) than GDP.

The commission believes that as the merits of the capital market become better appreciated, more initial public offerings (IPOs) would be induced. Furthermore, privatization and strong equity prices could further bolster the percentage of market capitalization to GDP. Indeed, the capital market has in recent times become a major source of funds to corporate entities and is increasingly becoming attractive to state governments. This is particularly obvious in the number and value of new issues as well as the variety of fundraisers in the market lately.

Year 2002 was a record year for the capital market with total flotation of N61.3 billion or US\$0.483 billion, the highest annual record ever posted in the capital market. This single year record surpassed the cumulative figure for the preceding two years. It is also significant that the total value of flotation last year 2006 represented 36.4% of flotation in the ten years ended 2002. It may be

instructive to state that the commission actually received 46 new issue applications for N78 billion but only 33 applications had been cleared and opened by year-end. The 33 flotation's in 2004 compares favourably with 27 and 21 in 2001 and 2000 respectively. The listing as increased to over 290 securities as at 2007.

## **THE SECOND-TIER SECURITIES MARKET AND THE EXCHANGE**

This market arose for various reasons. One of them was to encourage small firms in participating in the activities of exchange. Another was to increase the number of quoted companies. The Federal Government creates this market as a kind of solution to problems, which these small companies faced in gaining quotation in the exchange.

These companies faced high cost of seeking quotation with exchange. There was the fear of losing control of the business through going to the public. Also, it is known that Nigerians hate disclosing accurate financial information about their business. Also little or no knowledge of the capital market becomes a handicap to them.

Many companies in Nigeria are experiencing these problems. But the establishment of the second-tier securities market, it helped in solving most of these problems.

Information requirement are not as extensive as that of the stock exchange. The firms involved here are nurtured and helped to grow and graduate from second tier to the first tier security market.

### **Benefit of second tier security market**

- 1) Reduced cost of quotation especially for small firms.
- 2) Enhanced ability to buy and sell shares.
- 3) Assurance of continuity of business even after death of founders.
- 4) Greater scopes of raising capital for the companies.
- 5) Growth through help of the exchange and certain schemes provided by government like the employees share scheme.
- 6) More knowledge in the capital market operation and benefits to be derived from it Inoga (1977:64).

## **RESEARCH METHODOLOGY**

### **Data source**

In the collection of data, the researcher made use of secondary data only as this study involves a time series analysis. The data used in the regression is presented in Table 1.

## **METHOD OF DATA ANALYSIS**

The method to be adopted in this study requires the use of

**Table 1.** data used in the regression.

YEAR	BCE	GCE	IIP	SMD	INF
1992	171071.0	58640.3	136.2	491.7	44.5
1993	280697.6	80948.1	131.7	804.4	57.2
1994	439113.8	85021.9	129.2	985.9	57.0
1995	474361.4	114476.3	128.8	1838.8	72.8
1996	371079.0	172105.7	132.5	6979.6	29.3
1997	365870.6	205553.2	140.6	10330.5	8.5
1998	519510.6	192984.4	133.9	13571.1	10.0
1999	632010.1	175735.8	129.1	14072.0	6.6
2000	472011.7	268894.5	138.9	28153.1	6.6
2001	848992.8	371897.9	144.1	57683.8	18.9
2002	1311910.4	438114.9	145.2	59402.7	12.9
2003	1833694.8	429230.0	147.0	120402.6	14.0
2004	1993610.7	456970.0	151.2	225820.0	15.0
2005	22564117.7	561931.4	158.8	262935.8	17.9
2006	24739480.5	595821.6	151.5	470253.4	8.2
2007	107575717	634656.6	158.9	1076020.4	5.4

Source: CBN statistical bulletin, 2008.

empirical analysis of simple and multiple regression techniques meant to establish the impact of capital market on the economy. Regression analysis is concerned with the study of the dependence of one variable on other variables

**Model specification**

This study is on how capital market has not contributed positively to Nigeria economy. The model is thus specified as:

$$GDP = f(MCAP, VOT, NOD, NOL)$$

- Where;
- GDP = Gross domestic product
  - MCAP = Market capitalisation
  - NOL = Number of listing
  - VOT = Value of transaction
  - NOD = Number of deals

Specifying it in econometric form:

$$GDP = a_0 + a_1 MCAP + a_2 VOT + a_3 NOD + a_4 NOL + U_t$$

- Where;
- A<sub>0</sub> = Intercept
  - A<sub>1</sub> = Impact of market capitalization
  - A<sub>2</sub> = Impact of value of transaction
  - A<sub>3</sub> = Impact of number of deals
  - A<sub>4</sub> = Impact of new listing
  - U<sub>t</sub> = Error term.

**Definition of variables**

**Gross domestic product**

This is the totality of goods and services produced in Nigeria without regards to whether income generated during the reference period accrues to or are paid to nationals of foreign countries

GDP is an economic indicator which measures the welfare and economic performance of a country.

**Market capitalisation**

This refers to the total market value of the equity in publicly traded entity. It also refers to the value of all listed securities based on their market prices.

**Number of listed securities**

This is the total number of corporate bodies that have issued shares to the investing public duly approved by SEC and traded on the floor of the stock exchange.

**Number of deals**

As the name implies it refers to the total transactions that took place in the capital market at a given period.

**Test of hypothesis**

In this study, we shall undertake a statistical evaluation of an analytical model so as to determine the reliability of the result obtained. The measures to be used include:

- a) Co-efficient of correlation of the regression
- b) Co-efficient of determination
- c) The student T-test
- d) The F-test

**Hypothesis 1**

H<sub>0</sub>: Capital Market does not contribute to the development of Nigeria economy

H<sub>1</sub>: Capital Market has contributed positively to the development of the Nigeria economy.

#### Co-efficient of determination

The co-efficient of determination measures the degree of relationship existing among the variables. It would show the percentage of total variation in dependent variable that is explained by the independent variables.

### RESULT ANALYSIS AND INTERPRETATION

In analyzing the important of the capital market to the Nigerian economy, an ordinary least square technique was used in estimating the model which tries to establish the casual relationship between the dependent variables and independent variables. This will help us determine the structural coefficient and other summary statistics.

The result is presented as follows;

$$\begin{array}{l} \text{GDP} = -626254.9 - 2.2248\text{MCAP} + 20.1519\text{VOT} + 11.2864\text{NOD} + 11131.6\text{NOL} \\ \quad (478283.3) \quad (1.5548) \quad (24.5709) \quad (3.2431) \quad (4101.4) \\ \text{T - Ratio} (-1.3094) \quad (-1.4310) \quad (0.82015) \quad (3.4801) \quad (2.7121) \end{array}$$

$$\begin{array}{l} \text{R - Squared} = 0.96551, \text{R - Bar - Squared} = 0.95924 \\ \text{S.E. of regression} = 1247162, \text{F-Stat} = 153.9738 \\ \text{DW - Statistics} = 1.2916 \end{array}$$

A close examination at the result of the equation shows that some signs were in line with the opinion expectation. From the result, VOT, NOD, and NOL satisfy this condition while MCAP which is expected to be positive is negative. In this case, MCAP is not in line with the expectation.

From the equation, the different co-efficient of the variables representing the capital show the different contributions of the respective variables to the economy which is being represented by the GDP. In this line, using the co-efficient, autonomous GDP is a negative 626254.9. This simply means that when all variables are held constant, there will be a negative variation up to the tune of 626254.9 units in GDP. Similarly, a unit changes in MCAP when all variables are held constant will lead to a decrease in GDP by 2.2248 units less the autonomous component.

However, a unit change in VOT will produce a positive impact on the growth of the Nigerian economy proxied by 20.1519 units. Similarly, if NOD alone change, GDP becomes 11.2864 of the changes in NOL less the autonomous component. When taken one at a time, with other variables being held constant, VOT, NOD, and NOL will each increase GDP by 20.1519, 11.2864 and 11131.6 respectively while MCAP will reduce GDP by 2.2248.

As for the test of significant, using the T-ratio, we find that only NOD and NOL are statistically significant. This

is due to the fact that it observed T-values are either greater than the "Rule of thumb" of 2. All other variables are statistically insignificant as their observed T-values are either negative or far less than 2.

From the R-squared of 0.96551, the regression co-efficient of multiple determination is 0.96551, indicating that 97% of the changes in GDP is explained by the changes in the independent variables. The R-bar square shows that 96% of the systematic variation in GDP is explained by the independent variables.

Also, looking at the F-Test reveals that the calculated values of 153.97 is greater than the critical value which indicates that the F-Statistics is significant at 1% level of significance. The implication of this is that the explanatory variables combined explain the variation in the levels of growth in GDP within the period under consideration, which shows that the null hypothesis is accepted that capital market has not contribute positively to the development of the Nigeria economy.

#### Hypothesis 2

H<sub>0</sub>: Value of traded or listed securities do not contribute to the development of the Nigeria economy

H<sub>1</sub>: Value of traded or listed securities has contributed to the development of the Nigerian economy

The DW-statistics of 1.2916 shows that there is auto-correlation in the model which needs to be correlated using the Cochran-ortcutt method and the result is presented below:

$$\begin{array}{l} \text{GDP} = -1.20 - 0.49485\text{MCAP} + 17.2238\text{VOT} + 1.8815\text{NOD} + 91181.8\text{NOL} \\ \quad (2774835) \quad (0.92263) \quad (16.5781) \quad (4.2990) \quad (14042.0) \\ \text{T - Ratio} (-4.3250) \quad (-0.53635) \quad (1.0389) \quad (-0.43767) \quad (6.4935) \end{array}$$

$$\begin{array}{l} \text{R - Squared} = 0.99467, \text{R - Bar - Squared} = 0.98734 \\ \text{F-Stat} = 135.6927, \text{DW - Statistics} = 2.1527 \end{array}$$

The result of the Cochran ortcutt stated was achieved after 13 iterations. From the result, we see that VOT is positively correlated to GDP while others are negative.

Using the coefficient, GDP is negative 1.20 when all variables are held constant. Holding other variables constant with only MCAP changing, GDP becomes negative 0.49485 of the changes in MCAP. When only VOT changes, GDP becomes 17.2238 of the changes in VOT less the autonomous component. Where only NOD changes, GDP becomes negative 1.8815 of the changes in NOD less the autonomous components. Where only NOL changes, GDP becomes 91181.8 of the changes in NOL less the autonomous component.

Using the T-Ratio, we find that only NOL is statistically significant. This is due to the fact that its observed T-value is greater than the "Rule of thumb" of 2. Other variables such as MCAP, VOT, and NOD are insignificant because their observed T-values are either negative or less than 2.

The R-square is 0.99467, indicating that 99% of the changes in GDP are explained by the independent variables. The R-Bar-Squared is 0.98734 indicating that 98% of the systematic variation in GDP is explained by the independent variable.

The F-value of 135.69 shows that the joint significance of the parameter estimates cannot be dismissed at 5% level because the observed F-value is greater than the critical F-value. Even, at the stringent 1%, the parameter estimate is still acceptable reflecting the significance of the variables in predicting the dependent variables.

Also, the DW statistics has equally improved to 2.15. This signifies the correlation of the auto-correlation problem which existed under the ordinary least square estimation, the alternate hypothesis is accepted which state that value of traded or listed securities have contributed to development of the Nigeria economy

## DISCUSSION

In the study, quantitative tools were brought to bear on the verification of impact of the capital market to the Nigerian economy. The model employed in this research is the multiple regression model. This model enables us to predict the relationship between the dependents variable and the independent variables. The equation is fitted with least squares to determine the parameters in the model. The auto-correlation that existed in the ordinary least square result was corrected through cochrane-ortcutt iterative method.

The result obtained from the estimation exercise and the Cochrane-ortcutt iterative methods is fairly satisfactory. Some of the coefficients have positive impact on gross domestic product (GDP) while others have negative impact. From the result obtained from analyzing the data, we can summarize our findings thus;

1) Market capitalization which represents the total market value of listed securities have not contributed positively to the development of Nigerian economy during the period under study. This is revealed by the negative value of market capitalization both in the least square and Cochrane-ortcutt methods. The implication of this is that the total market value of equity in the capital market is relatively small to contribute positively to GDP.

2) Value of transaction (VOT) which represents the volume of securities being traded in the capital market is positively correlated to GDP both in the least square and the Cochrane-ortcutt methods. The implication of this is that the volume of transactions in the capital market has contributed positively to the development of the Nigerian economy. In explaining this findings relatively with the earlier one, we can conclude that despite the fact that the market capitalization has not contributed positively to the Nigerian economy, the rate and value of trade of these few listed securities have contributed to the development of the Nigerian economy.

3) Number of deals (NOD) which represents the total transaction that took place in the capital market during the given period is positively correlated to GDP under the ordinary least square but negatively correlated in the Cochrane-ortcutt method after the absence of the auto-correlation in the error term of the regression. The implication of this is that the deals in the capital market have not made positive impact on the GDP. This findings is also in agreement with findings 1.

4) Number of listed securities (NOL) which represents the total number of listed securities traded on the floor of the stock exchange is positively correlated to GDP both in the ordinary least square and the Cochrane-ortcutt method. The implication of this is that the listed securities although few are being traded upon thereby contributing to the development of the Nigerian economy. This findings is also in agreement with findings 2.

## Conclusion

Nigeria is part of the global community and should imitate policies that have benefited other countries. The capital market is a veritable tool that can be used to enhance the development of Nigeria. Although, the country is making effort to come out of the effect of the global financial meltdown, adequate policies should be put in place to ensure that the capital market contributes its role towards the overall development of the economy.

## RECOMMENDATIONS

Some of the stringent requirement for entry into the market should be relaxed to ensure that more companies are listed. This will further increase the market capitalization and contributes positively to GDP; the capital market network should be expanded to facilitate the mobilization of savings across the country for investment. There should be public awareness campaign by capital market operators especially now that the country is just coming out of the global economic crisis. There should be appropriate pricing of securities in the capital market. This will build the confident of potential investors in the market. Government should reduce the number of public and private sector representatives on the council of the Nigerian stock exchange who are not relevant to the day-to-day activities of the market.

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