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THE ROLE OF STOCK MARKET AND ECONOMIC GROWTH IN NIGERIA

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ABSTRACT

Nigerian stock exchange has existed since 1961, it truly began to operate effectively when the civilian government returned to power in Nigeria in 1999. Until recently, the trading activity in the Nigerian stock market was quite limited; as a result, the prices exhibited considerable stability, which can be seen by analyzing the turnover ratio during that time frame. Most research conducted on the Nigerian stock market has focused on market efficiency.This study examines the role of the stock market in driving economic growth in Nigeria over the period 1993 to 2023, utilizing the Ordinary Least Squares (OLS) regression method. By analyzing time series data, we assess the impact of stock market indicators such as market capitalization, stock turnover ratio, and trade volume on Nigeria's Gross Domestic Product (GDP). The OLS approach is employed to investigate the linear relationship between stock market performance and economic growth, addressing potential challenges such as multicollinearity, autocorrelation, and heteroskedasticity within the dataset. Results reveal a statistically significant, positive correlation between stock market development and economic growth in Nigeria, suggesting that an efficient stock market may stimulate economic expansion by facilitating capital formation and resource allocation. This study offers insights for policymakers, emphasizing the need to strengthen Nigeria's stock market infrastructure and regulatory environment to foster sustainable economic growth.

1.0 INTRODUCTION

The Nigerian stock market was founded in 1960 but began trading on June 5, 1961, with eight initial securities, including five government bonds and three equities. Over the years, the growth of the securities markets in Nigeria has been gradual. As of 2020, the current number of securities in the market stands at 360. Although the Nigerian stock exchange has existed since 1961, it truly began to operate effectively when the civilian government returned to power in Nigeria in 1999. Until recently, the trading activity in the Nigerian stock market was quite limited; as a result, the prices exhibited considerable stability, which can be seen by analyzing the turnover ratio during that time frame. Most research conducted on the Nigerian stock market has focused on market efficiency. Various studies have assessed the Nigerian stock market against the Fama efficient market hypothesis. Some of these studies indicate that the Nigerian stock market is semi-strong efficient, but the majority suggest that it demonstrates weak form efficiency. Adelegan (2003) investigated the Nigerian stock market by analyzing adjusted share prices in relation to dividend announcements from 1991 to 1999.

He observed that in the samples, the returns were negative prior to the announcement and positive following the announcement. Adelegan (2003) similarly discovered that in Nigeria, dividend and earnings announcements occurred simultaneously, unlike in developed stock markets where they are made separately. The stock market is regarded as a tool to promote savings, facilitate the allocation of savings into productive investments, and enhance the efficiency and productivity of such investments. The focus on the development of stock markets for domestic resource mobilization has also demand for non-debt creating foreign capital has led to a strengthening of the available equity market. This equity market can enhance the competitiveness and efficiency of the financial system. In the absence of equity markets, companies must depend on internal financing through retained earnings. Larger and more established businesses hold an advantageous position because they are able to fund investments using retained earnings and bank loans, whereas new firms face challenges in accessing financing. When not subject to stock market scrutiny, larger companies continue to expand, while emerging smaller businesses may find that retained earnings and additional cash infusions from their principal shareholders are insufficient to meet their equity financing needs, which could be addressed by an organized marketplace. The corporate sector would benefit from the demands of equity markets, which necessitate the establishment of widely accepted accounting standards and the regular disclosure of sufficient and dependable information. While privately held companies may be able to disguise poor investment choices and low profitability for some time, publicly traded companies do not have that luxury. Access to trustworthy information would enable investors to compare the performance and long-term potential of companies, assist corporations in making more informed investment and strategic choices, and provide improved statistics for economic policymakers. The success in accumulating and mobilizing capital for development differs among countries,

but it largely relies on domestic savings and foreign capital inflows. Therefore, to counter the current economic downturn, efforts must be focused on effective resource mobilization. It is with this understanding that measures are evaluated to develop the capital market as an institution for transferring finance from surplus sectors to deficit sectors.

Levine (1991) demonstrated a positive correlation between financial stock markets and economic growth by providing new financial resources to firms. The financial stock market encourages higher investment levels and capital allocation, which indirectly promotes economic growth. At times, investors may shy away from directly investing in companies because they can't easily retrieve their funds when they wish. However, through the financial stock market, they can quickly buy and sell stocks, thereby gaining more freedom. A well-functioning stock market helps attract more investment by financing productive projects that contribute to economic growth, mobilizing domestic savings, allocating capital effectively, minimizing risk through diversification, and facilitating the exchange of goods and services (Mishkin 2001; Caporale et al., 2004).

1.2 Statement of the Problem

The influence of the stock market on the economy's growth and development has not been adequately experienced (Babalola, 2007) due to several issues, including the market's small size, illiquidity challenges, sluggish performance of the security market, ineffective underwriting, delays in issuing share certificates, double taxation, and macroeconomic instability, among others. Additionally, various criticisms have been directed at the capital market's failure to fulfill its intended purpose (Pat Donwa, 2010). However, Osaze (2000), Ekundayo (2002), Oyefusi and Mogbolu (2003), Equakun (2005), and Adelegan (2005) contend that the capital market has the potential to stimulate the economic growth of any country.

To explore how the stock market contributes to the economic growth of Nigeria. The study will explore the following objective, establish the type of connection between the stock market and economic growth.investigate the factors that influence investment in the stock market and assess the relationship of causation between economic growth and the stock market.

2.0 LITERATURE REVIEW

The stock market serves as the foundation of every financial system, as it supplies the necessary funds to support businesses, various economic institutions, and government programs overall. The capital market principally consists of a marketplace for long-term securities like stocks, debentures, and bonds, which typically have durations exceeding three years. The capital market did not operate effectively until the Central Bank was established in 1959 and the Lagos Stock Exchange was inaugurated in 1961, despite the fact that securities had been issued as early as 1946. The need for a structured stock exchange arose, prompting the government to form a committee led by Prof. R.W. Barbock to evaluate the viability of creating a local platform for buying and selling shares and stocks.

There is a wealth of research regarding the importance of the capital market for the economy. We aim to explore the connection between savings,

investments, the capital or stock market, and economic expansion.

2.1 Stock Market Theories

The investment theory was introduced by Tobin in 1969. This dynamic investment theory asserts that the choices regarding investment are influenced by the ratio of a firm's financial asset market value to its replacement cost. If we represent the market value of existing assets (MVA) in relation to their replacement cost as CRA, we can symbolically denote the Q theory using the q ratio.

$$Q=\frac{MVA}{CRA}$$

The value of q within the ratio assists the firm in making investment choices, hinging on whether the analysis is conducted in the short run or the long run. In the short run, q may not equal one due to lags and imbalances in the relevant factors. However, these lags and imbalances are resolved in the long run, during which the price of capital aligns with its productivity. When q exceeds one, pursuing an investment proposal becomes a sensible decision, but it would be illogical if q is below one. The rationale is that investment becomes worthwhile only if the returns on the initial investment enhance the firm's market value.

3.0 RESEARCH METHODOLOGY

3.1 Research Design

The research design for this study utilized a survey approach. This design was appropriate as it aims to explore the connection between the independent variable (stock market) and the dependent variable (economic growth). To analyze the data gathered from 1993 to 2023, the ordinary least squares (OLS) regression analysis method was employed.

3.2 Model of the Study

Based on previous research and theoretical discussions, and in accordance with Dritsaki and Dritsaki-Bargiota (2005), the multivariate model is outlined below with certain adjustments made to align with the unique aspects of the Nigerian economy, and we will continue to examine the long-run relationships among the variables included in the model. The explanatory variables [(mcap), (tvstr), and (mcr)] in equation (1) presented below will be incorporated into the model one at a time as previously described.

$$Yr = \beta_0 + \beta_{1GDP} + \beta_{2MCAP} + \beta_{3MCR} + \beta_{4(DS)} + \beta_{5(TVST)} + \beta_{6cf} + E_i \text{----------1}$$

3.3 Model Specification

The model's functional form specification is presented below. It demonstrates that economic growth, represented by real GDP, is functionally connected to market capitalization, the market capitalization ratio, cash flow, domestic savings, the values of stocks traded, and total new issues.

$$LogGDP = f(logMCAP, logMCR, logDS, logTVST, logCF) \text{----------2}$$

3.3.1 Econometric Specification

$$LogGDP=a_0+a_1logMCAP + a2logMCR + a3logDS + a_4logTVST+ a5logCF\mu \text{.....3}$$

Where $a1 = a2 = a3 = a4 = a5 > 0$

We utilize GDP as an indicator for the economic growth rate during the specified timeframe, MCAP serves to denote market capitalization for that period, while DS signifies total savings that correspond to investment as per Keynesian theory. TVST refers to the overall value of stocks traded. All parameters are positive, illustrating a favorable correlation between economic

growth and the explanatory variables. μ denotes any other factors that could affect the regression, often referred to as the error term.

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$GDP_t=\sum a_0 DS_{t-I} + \sum a_1 GDP_{t-j}+U_{1,t}$----------4a

i=1 j=1

nn

$DS_t=\sum \beta_0 GDP_{t-I} +\sum \beta_1 DS_{t-j}+ U_{2,t}$----------4b

i=1 j=1

Where GDP_t and GDP_{t-i}represent both present and lagged values of the dependent variable and $DS_t$and DS_{t-I} represent the current and lagged values of the explanatory variable respectively.

Where:

GDP= Gross Domestic Product

MCAP=Market Capitalization

MCR =Market Capitalization Ratio

DS = Domestic Savings

TVST = Total Value of Shares Traded

CF = Cash Flow

4.0 DATA PRESENTATION AND ANALYSIS

The summary statistics for the variables: MCAP, DS, GDP growth rate, market capitalization ratio, TVST, and TVST ratio are presented in Table 4.2 below. The average values for the previously mentioned variables are 5.75, 4.97, 4.97, 1.50, 76.51, and 52.09, respectively.

Table 4.1: Summary Statistics of the Variables

	N	Minimum	Maximum	Sum	Mean	Std. Deviation	Variance	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
MCAP	30	1.00	7470.70	1.78E4	5.7550E2	1725.75966	2.978E6	3.685	.421	12.694	.821
DS	30	265.38	720.94	1.54E4	4.9785E2	177.37503	3.146E4	-.151	.421	-1.751	.821
GDP_Growth_Rate	30	265.38	720.94	1.54E4	4.9785E2	177.37503	3.146E4	-.151	.421	-1.751	.821
MC_Ratio	30	1.00	980.72	4651.04	1.5003E2	235.27354	5.535E4	2.622	.421	6.700	.821
TVST	30	.23	685.72	2371.97	76.5152	149.46882	2.234E4	3.110	.421	10.046	.821
TVST_Ratio	30	.09	331.10	1615.08	52.0994	72.22524	5.216E3	2.665	.421	8.155	.821
Valid N (listwise)	30										

Source: E-views 10

The table provided displays the descriptive statistics of the data utilized in this study, outlining the distribution characteristics such as the mean, standard deviation, and variance. Additionally, it indicates that the skewness and kurtosis of the dataset fall within the acceptable range for normality.

4.3 Presentation of Regression Result

TABLE 4.2: Summary of Regression Result

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1977.713	1.258		1.572E3	.000
	MCAP	.2991	.000	.054	1.375	.041
	MC Ratio	.006	.007	.165	.895	.039
	TVST	.022	.011	-.359	-1.911	.000
	TVST Ratio	-.027	.006	-.212	-4.437	.068
	DS	.059	.003	1.145	22.515	.000

Source: E-views 10

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.982[a]	.964	.956	1.903

Source: E-views 10

The model derived from table 4.3.1 is as follows:

Economic Growth = 1977.713 + 0.2991MCAP + 0.006MCR + 0.022TVST - 0.027TVSTR + 0.059DS ……(1)

Each b-coefficient reflects the average increase or decrease in economic growth that is associated with a unit increase or decrease in the predictor variable. The b-coefficient is considered statistically significant if the "Sig." or p-value is less than 0.05. According to the results, all predictors are significant except for the TVST Ratio.

Beta coefficients (standardized regression coefficients) are used to compare the relative strengths of the most influential predictors in the coefficient table.

To investigate the presence of stochastic non-stationarity in the series, this paper assesses the order of integration of the individual time series by employing unit root tests such as the Augmented Dickey Fuller (ADF)

Table 4.4 ADF and PP Unit Root Tests

Variable	ADF			Phillips-Perron		Remarks
	Level	1st Difference	Remarks	Level	1st Difference	
Yr	-3.8431**		I(0)	-9.8785***		I(0)
Gdp	-3.5161**		I(0)	-3.0568**		I(0)
Tvstr	-2.364	-3.2443***	I(1)	-2.0954	-10.8301***	I(1)
Mcr	-2.364	-3.2443***	I(1)	-2.0954	-10.527	I(1)
Mcap	-3.8373**		I(0)	-3.7879**		I(0)
Tvst	2.9991	-3.3568***	I(0)	-0.7953	-3.5818***	I(0)

Source: E-views 10

The variables examined include: yr, gdp, mcap, mcr, ds, tvst, and tvstr. The findings shown in table 4.5 suggest that yr, gdp, mcap, and tvst are stationary at their levels, where astvstr and mcr are non-stationary at their levels. Nonetheless, the latter group of variables tvstr and mcr demonstrated stationarity after the first difference, indicating that they are I(1) series.

5.0 CONCLUSION AND RECOMMENDATIONS

The research aimed to investigate the influence of the stock market on Nigeria's economic growth and to explore the causal relationship between the two factors. The findings revealed that economic growth is a Granger cause for the expansion of the stock market. Additionally, we found that the stock market can contribute to economic growth primarily through market capitalization and an increase in the value of traded stocks. Globally, the stock market plays a crucial role in achieving economic growth and development, and this should hold true for Nigeria as well. We recognize the presence of unethical practices, such as hoarse trading, within the Nigerian Stock Market, which are being carried out by individuals responsible for ensuring the market supports economic growth. Finally, the Securities and Exchange Commission is

taking steps to address and reform the system.

5.1 Recommendations

According to the results of this study, the subsequent policies are suggested.

- To begin with, our findings on causality indicate that economic growth leads to a rise in the stock market in Nigeria. Therefore, we urge the Nigerian government to implement policies that will encourage economic expansion, specifically growth that is fueled by investment..
- Moreover, given that domestic savings does not show a statistically significant connection with the link between the stock market and economic growth, we recommend that the government focus on other significant factors such as market capitalization and the value of stocks traded in the capital market.
- Finally, we recommend that the government take into account the scale of the Nigerian Stock Market in relation to its market capitalization if it aims to be a global competitor and a facilitator of economic development.

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