Article

Analysis of Stock Market Development, Foreign Private Investment and Economic Growth in Nigeria

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Abstract

The study estimated the impact of stock market development and foreign private investment on economic growth in Nigeria over the period of 1985–2016, using secondary data from various publications of the Central Bank of Nigeria. The ordinary least square (OLS) technique was employed in this study, while the Engel and Granger co-integration approach was applied to determine the long-run relationship between the variables. The result showed that market capitalisation, all share index and real exchange rate have statistically significant impact on economic growth, while foreign direct investment, trade openness and gross national savings have insignificant impact on growth. The study also showed that there is a long-run relationship among stock market development, foreign private investment and economic growth in Nigeria. The error correction model (ECM) results showed that the model adjusts to equilibrium in the short run and that about 51 per cent of the disequilibrium between gross domestic product and the independent variables is corrected each year. The study recommended that policymakers and monetary authorities should gear efforts towards formulating policies that will fine-tune stock market performance and reduce issues, such as, unpaid dividends, delay in dividend payments and unhealthy transfer of stocks. This is pertinent to encourage greater population of the citizenry to invest in the stock market. Finally, the study concluded that provision and improvement of infrastructure and power as well as enforcement of investor-friendly policies by the government is needed as these will encourage the establishment of more firms and industries that will participate in the stock market, thereby contributing to the growth of the economy.

JEL Classification: E22, F21, F43, O16

Keywords: Stock market, foreign private investment, economic growth

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1. Introduction

Many developing countries like Nigeria are characterised by low level of domestic savings, which has impeded the much-needed investment for economic development. In order to attain a desirable level of investment that would ensure sustainable development, developing countries need some foreign saving to bridge the savings–investment gap. The gap when financed through foreign savings comes in the form of capital flows. Capital flows are transmitted through foreign direct investment (FDI), foreign portfolio investment (FPI) and draw down on foreign reserves, foreign loans and credits and so on (Obadan 2004). The factors that usually determine the volume and flow of foreign capital include, among others, exchange rate policies, political instability, monetary and fiscal policies, domestic factors such as the investment environment, infrastructure and resources and the quality of institutions (Udoh and Egwaikhide 2008). For example, in 2012, Nigeria received a net inflow of US$85.73 billion of FDI. Much of these foreign inflows came from Nigerians in the diaspora and other multinational corporations. The FDI is arguably an important source of employment opportunities for developing countries like Nigeria. According to World Bank (2017), FDI in Nigeria increased by US$798.35 million in the third quarter of 2017. The FDI in Nigeria averaged US$1317.76 million from 2007 until 2017, reaching an all-time high of US$3084.90 million in the fourth quarter of 2012 and a record low of US$501.83 million in the fourth quarter of 2015.

In Nigeria, although large market and abundant natural resources tend to attract foreign investors, certain factors still inhibit the inflow of foreign capital into the country. Among such factors are inadequate basic infrastructures, insecurity, exchange rate fluctuations, corruption, weak institutions and so on. All over the world, the capital market has played significant roles in national economic growth and development. One intermediary in the market that operates as a rallying point for the overall activities is the stock exchange. It is a common postulation that without a functional stock market, the capital market may be very illiquid and unable to attract investment. Essentially, the stock market provides liquidity and contributes to capital formation and investment risk reduction by offering opportunities for portfolio diversification (Levine 1991).

The liquidity role stands out clearly as the most significant among the numerous functions provided by the stock market. According to Levine (1997), without a liquid stock market, many profitable long-term investments would not be undertaken because savers may be reluctant to tie up their investments for long periods of time. The stock market mainly provides liquidity by enabling firms to raise funds through the sale of securities with relative ease and speed. Through this catalyst role, the stock market is also able to influence investment and economic growth in general. As argued by Mohtadi and Agarwal (2004), large stock markets lower the cost of mobilising savings, facilitating investments in the most productive technologies. 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 tries to efficiently allocate these funds to projects of best returns to fund owners. Foreign private investment, thus, augments domestic resources to enable the country carry out effectively her development programmes and raise the standard of living of her people. Although foreign private investment is made up of FDI and FPI, FDI is often preferred as a means of boosting the economy. This is because FDI disseminates advanced technological and managerial practices through the host country and thereby exhibits greater positive externalities compared with FPI which may not involve positive transfers, just being a change in ownership. In addition, available data suggest that FDI flows tend to be more stable compared to FPI (Lipsey 1999). The functioning of the capital market affects liquidity, acquisition of information about firms, risk diversification, savings mobilisation and corporate control (Anyanwu 1998). Therefore, by altering the quality of these services, the functioning of stock markets can alter the rate of economic growth (Equakun 2005).