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Capital Market Development and Economic Growth in Nigeria

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Abstract

Given the crucial role of the capital market in the economic growth process, this study through the financial intermediation theory lens attempts to evaluate the impact of capital market development on economic growth in Nigeria by developing a parsimonious model of economic growth using capital market development indicators as predictors. Thus, this study evaluated the proposition that capital market development can spur economic growth by testing the three hypotheses to find out if capital market proxied by Market Capitalization (MC), Market Turnover (MT), and Total Transaction Value (TTV) significantly influences economic growth proxied by gross domestic product (GDP) in Nigeria. The evidence of this study provided that among the dimensions of capital market development understudied, only market capitalization could significantly predict economic growth in Nigeria. This is a result of the shallow market depth of the Nigerian capital market since the market is characterized by low liquidity and limited trading volumes. This outcome implies that raising necessary funds for business development will be difficult, and this will stunt the growth of businesses and their contribution to the economy. Also, access to long-term funds for expansion, innovation, and modernization would be limited. Therefore, positioning the Nigerian capital market to drive economic growth requires comprehensive and coordinated efforts to boost the market depth and enhance its liquidity. This includes encouraging the listing of more firms especially from diverse sectors, by offering tax incentives, reduced listing fees, and streamlined listing requirements.

Keywords: capital market; economic growth; financial intermediation;

INTRODUCTION

Historically, economic growth has been influenced by factors like capital, labour, and technology, however, in recent times financial crises have shown that a lack of confidence in the financial system has negative consequences on the economy (Abayomi & Yakubu, 2022; Udofia *et al.*, 2022; Olubunmi, 2021). Therefore, the interplay between capital markets and economic development in any economy is important and requires attention. This is because, the capital market facilitates the mobilization and allocation of long-term capital, essential for infrastructure development and industrial expansion. In Nigeria, efficient capital markets have been crucial for financing large-scale projects and driving economic growth (Chikwira & Mohammed, 2023; Abayomi & Yakubu, 2022; Ayeni & Fanibuyan, 2022; Ikeobi, 2020). Therefore, the importance of the capital market in the economic growth process cannot be overemphasized and requires interrogation. According to Didier, *et al.* (2020) the capital market provides the platform for trading a variety of financial instruments, this enables investors to diversify risks, thereby stabilizing the financial system. This, in turn, promotes sustained economic growth. Also, as argued by Adjasi *et al.* (2022) better corporate governance practices, enforced through capital markets, can enhance investor confidence and attract more investment, spurring economic growth. Similarly, well-functioning capital market attracts foreign investors looking for profitable opportunities. Increased FDI brings in capital,

technology, and expertise, contributing significantly to economic growth (Haruna *et al.*, 2023). Thus, the development of capital markets triggers broader economic reforms, including improvements in legal and regulatory frameworks. Such reforms enhance the overall business environment, fostering economic growth. Capital market development can be mirrored via the growth in market capitalization, total transaction value, and market turnover (Kapaya, 2020). The market capitalization explains the size of the market and increases in market capitalization mirror the capability of the stock market to mobilize and allocate capital (Kapaya, 2020). The total transaction value accounts for the depth of the market and explains how liquid the market is in terms of the quickness of transferring funds between sellers and buyers (Kapaya, 2020). The market turnover depicts how efficient the market is, it measures trading relative to the size of the stock market and how efficient the stock market is in mobilizing and allocating resources (Kapaya, 2020).

The Nigerian capital market is considered an important part of the economic growth process (Okekwu et al., 2022; Iortyer & Maji, 2022; Iyaji, & Onotaniyohwo, 2021). The market has recently expanded with the all-share index standing at 51,251.06 points as of December 2022 (CBN, 2022). The value of transactions stood at N1.168 and total market capitalization hit N51.251 trillion as of December 2022 (CBN, 2022). The market turnover ratio stood at 2.4 in December 2022, showing fewer investors are trading the market. However, the question still arises of how impactful is the capital market on the Nigerian economy. According to Kolawole (2022) the Nigerian economy suffered setbacks in 2016 and 2020 which signals a distressing financial system. Also, the failure of the Nigerian capital market to incorporate all information into the price of a share to reflect its fair price poses a challenge. This might be due to some challenges in the Nigerian capital market which include a significant level of volatility in the market, which can deter investment and negatively impact economic growth (Angaye and Bingilar, 2020), and poor institutional and regulatory frameworks which affect investors protection and the integrity of the market (Haruna *et al.*, 2023b). The unavailability of timely and accurate information to all participants represents another challenge to the capital market in Nigeria. The need for technological infrastructure to drive the operations of the capital market and enhance its growth is also compelling.

Though there have been efforts to address these challenges and improve the capital market in Nigeria such as the transitioning of the Nigerian Stock Exchange from a mutual exchange owned by members to a publicly listed company to enhance governance and attract broader investors' participation, and the implementation of the X-Gen trading platform to enhance efficiency and reduce transaction cost. Other efforts include the establishment of the Financial Market for Development and Quotes OTC securities exchange to facilitate the trading of fixed-income securities and derivatives providing an alternative investment window and contributes to market depth. Other alternative investment avenues include Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs) to diversify investment options available to investors. To foster sustainable development, the issuance of green bonds aims to finance environmentally sustainable projects and attract socially responsible investors to the market.

Despite these efforts, the question still arises of the capacity of the Nigerian capital market to promote sustainable economic growth. Providing answers to this question is the main motive of this study. Therefore, this study explored the impact of capital market development on economic growth in Nigeria using market capitalization ratio (MC), total transaction value ratio (TTV), and market turnover ratio (MT) ratio as proxy for capital market development and Gross Domestic Product as proxy for economic growth. The uniqueness of this study is that it

accommodates recent data sets from 1993-2022 plus the recent improvements and advancements in capital market technology. This study provided feedback on the interplay between Nigeria's capital market and economic growth and made valuable suggestions to enhance the relationship.

LITERATURE REVIEW

Theoretical Framework

The financial intermediation theory proposed by Gurley and Shaw (1960) provides the theoretical underpinning for this study. Originally, the financial intermediation theory has its roots in the early works of economists such as John Maynard Keynes, who emphasized the role of banks in channeling savings into investments. However, it gained significant traction in the latter half of the 20th century when notable proponents such as Gurley and Shaw, whose influential book in the 1960s highlighted the importance of financial intermediaries in the economic system, arguing that they serve a distinct role in mobilizing and allocating funds more efficiently. Since then, the theory remained relevant in linking capital market development and economic growth. The theory explains the role of financial intermediaries such as banks and other financial institutions as catalysts in economic growth. The theory compensates for information asymmetry and transaction costs in the financial market (Morrison, 1967). According to the financial intermediation theory, financial intermediation exists to mitigate information asymmetry and transaction costs in the financial market by pooling resources from multiple lenders, making it more efficient and cost-effective than if lenders perform these functions individually. The theory contends that financial intermediation addresses the issues of imperfections in the financial market created by informational asymmetry, reduces transaction costs (Allen, 1991), and ensures regulatory compliance (Merton, 1995). This ultimately facilitates capital flow and supports economic growth. Also, the theory highlights the role of financial intermediaries (such as banks, investment firms, and stock markets) in providing funds to firms that require long-term funds to pursue innovation and contribute to economic growth. This underscores how a well-functioning capital market can contribute to economic development by facilitating investment, improving resource allocation, and fostering innovation.

Thus, well-developed capital markets improve the efficiency of financial intermediation by providing more investment opportunities and better risk diversification (Beck & Levine, 2000). Therefore, the nexus between capital market development and economic growth mirrored the role of the capital market in enhancing financial intermediation, reducing information asymmetry, reducing transaction costs, providing liquidity, and facilitating risk sharing and diversification (Beck & Levine, 2000). The theory highlights the importance of financial intermediaries as catalysts in the economic growth framework, thereby suggesting that the efficiency and effectiveness of Nigeria's capital market as a financial intermediary can significantly stimulate economic growth.

Empirical Review

Empirical investigations have underscored the need for a developed capital market as an essential financial intermediary in the economic growth framework. The association between capital market and economic growth in Nigeria has also been explored in several studies. These include Chikwira and Mohammed (2023) who examined the impact of the stock market on liquidity and economic growth in Nigeria. Employing the Vector Autoregressive model (VAR) the study revealed that the stock market positively and significantly influenced economic growth. Similarly, Okekwu *et al.* (2022) evaluated capital market and economic growth nexus

in Nigeria from 1986-2021. They employed the Autoregressive Distributed Lag (ARDL) and found market capitalization to positively contribute to Nigeria's GDP. They concluded that the size of a capital market has a considerable beneficial impact on the economy in the long and short run. Also, according to Umar (2022) despite the differences in the level of the development of the capital market across the globe, the performance of the capital market is a major boost to the growth of the economy. Using the Systematic Quantitative Assessment Technique (SQAT), Umar (2022) evaluated the impact of capital market performance on economic growth in Nigeria from 2012 to 2021 and found capital market performance to significantly influence economic growth.

A study by Itiveh and Okolie (2022) on capital market operations and economic growth in Nigeria from 1999 to 2021 revealed that efficient capital market operations have the potential to significantly boost Nigeria's economic growth. The study utilized market capitalization, total new issues, and value of transactions as dimensions of capital market operations, and the OLS regression technique was employed to analyze the study's data. The study concluded that a well-developed capital market is crucial for economic growth. Keji (2020) in an attempt to examine the nexus between the capital market and economic growth in Nigeria between 1980 and 2017 employed the Autoregressive Distributed Lag model (ARDL), the study established that there is a long-run relationship between the capital market and economic growth in Nigeria. Another study by Ugbogbo and Aisien (2019) implemented the co-integration and error correction model to evaluate capital market development and economic growth in Nigeria from 1981 to 2016. The empirical findings revealed that capital market development measured as market capitalization has a significant and positive impact on economic growth in Nigeria both in the short-run and in the long-run. Similarly, Avery and Obah (2018) examined the impact of capital market growth on Nigerian economy between 2000 and 2013 employing Nonlinear Autoregressive Distributed Lag (NARDL) technique. The study found a strong correlation between economic growth and market capitalization. Also, the finding showed that market capitalization has a significant impact on the GDP of Nigeria. Therefore, the study argued that the capital market accounts for the growth and development of the economy.

In another development, Toby and Dibiah (2021) experimentally looked at the link between capital market improvement and monetary development in Nigeria. Employing the Vector Autoregression (VAR), the study found that the ratio of the value of stock to GDP is not significant in influencing the real GDP growth rate, while the market capitalization ratio to GDP significantly influences the GDP growth rate in Nigeria. Also, the outcome showed that the banking system capitalization ratio to market capitalization does not significantly influence the real GDP growth rate in Nigeria. The study argued that the capital market is not the main driver of financial development and that irrespective of its size, the illiquidity of the Nigerian capital market makes it less active in driving economic growth. Similarly, Muritala and Ogunji (2017) in answering the question "Does the capital market spur economic growth? Evidence from Nigeria from 1980 to 2015" arrived at a mixed finding after implementing the OLS regression technique. The study found market capitalization and total listing to positively impact the economy while the value of transactions has negative impact on real GDP. Angaye and Bingilar (2020) examined the effect of capital market development on the economic growth of Nigeria between 2008 and 2018. The study employed multiple regression analysis and found that the stock market has an insignificant effect on the economic growth in Nigeria. Also, Ughulu and Osas (2020) examined capital market operations and economic growth in Nigeria from 2000 to 2018. After implementing OLS regression technique, the outcome of the study revealed that market capitalization and all shares index are not significant in influencing

economic growth in Nigeria. In the same vein, Adigwe *et al.* (2015) empirically examined stock market development and its contributions to economic growth in Nigeria from 1985 to 2014. The study employed OLS regression technique and revealed that the stock market has growth-inducing potential but has not contributed meaningfully to Nigerian economic growth since only 26.5% of the variations in economic growth were explained by the stock market development variables.

From the foregoing literature, there are questions on the dimensions of capital market development employed. For instance, Okekwu *et al.* (2022) used market capitalization and volume of listing alongside other variables, while Umar (2022) mainly studied the price efficiency via all shares indexes without considering other dimensions of the market. Also, Itiveh and Okolie (2022) used market capitalization, total new issues, and value of transactions as dimensions of capital market operations from 1999 to 2021, the choice of OLS regression technique to analyze the data is suspicious. Therefore, this study addresses these inadequacies by i) capturing the three (3) most important dimensions of capital market development without dilution with other variables; ii) implementing appropriate methodology.

This study therefore proposed that: Capital market development is essential in the growth process of the Nigerian economy.

To evaluate this proposition, this study developed a parsimonious model of economic growth using the capital market development dimensions of market capitalization ratio (MC), total transaction value ratio (TTV), and market turnover ratio (MT) as antecedents.

METHODOLOGY

The study used quantitative research approach and the design is the ex post facto category of descriptive research. Autoregressive Distributed Lag (ARDL) technique developed by Pesaran and Shin (1999) and re-assessed by Pesaran, Shin & Smith (2001) is used to estimate the capital market development and economic growth short-term and long-term associations. The ADRL is a more robust tool as it is not sample sensitive like the Vector Autoregression (VAR) approach. Using ARDL, adjusting the data would not be necessary since it would still be possible to calculate long-run relationships. Also, short-run impact of given variables are integrated with long-run equilibrium using error correction term without dropping long-run information, making it possible to simultaneously assess both relationships.

The study used time series data from 1993 to 2022 sourced from World Bank Database to examine the impact of capital market development on economic growth in Nigeria. The explanatory variable which is capital market development is proxied by Market Capitalization (Itiveh & Okolie, 2022; Okekwu, 2022; Toby & Dibiah, 2021), Total Value of Transactions (Adjasi *et al.*, 2022; Itiveh & Okolie, 2022), and Market Turnover (XXX) while the response variable is economic growth proxied by Gross Domestic Product (GDP). The choice of the explanatory variables is to sufficiently capture capital market development using the three (3) most important dimensions of capital market development.

RESULTS AND DISCUSSION

Unit Root Test

The unit root test was performed in this study to ascertain the order of integration of the variables employed in the study. To achieve this, the Phillips-Perron (PP) test proposed by

Phillips and Perron (1988) was conducted to determine the stationarity of the variables employed in this study and ensure that second-order integration is not present in any of the variables. The goal of this test is to eliminate the possibility of producing spurious estimations in the regression model. The outcome of the unit root test in Table 1 revealed a mixed order of integration with a combination of I(0) and I(1). This means that the traditional OLS regression technique would not be suitable for analyzing the data and such justifies the choice of ARDL technique for this study. Also, the absence of second-order integration in the unit root test performed eliminates the possibilities of spurious estimations.

Table 1: Unit Root Test

Variables	At Level I(0)		At First Difference I(I)	
	No Constant & Trend	Constant & Trend	No Constant & Trend	Constant & Trend
	T-Stat (P-Value)	T-Stat (P-Value)	T-Stat (P-Value)	T-Stat (P-Value)
RGDP	-1.5136 (***0.1198***)	-2.6840 (***0.2498***)	-8.1616(***0.00***)***	-13.9548 (***0.00***)***
MC	-0.7896 (***0.3653***)	-3.5601 (***0.0515***)*	-7.1153 (***0.00***)***	-6.9469 (***0.00***)***
TTV	-1.9993 (***0.0453***)**	-2.5197 (***0.3170***)	-5.7330 (***0.00***)***	-5.9557 (***0.00***)***
MT	-1.2096 (***0.2021***)	-2.1200 (***0.5138***)	-6.5495 (***0.00***)***	-12.0544 (***0.00***)***

Note: ******, ** and * indicate statistical significance at 1%, 5% and 10% respectively***
Source: Author's computations, 2024

Autoregressive Distributed Lag

To determine the existence of long-run relationship among the variables, the ARDL bounds test of cointegration was estimated and the outcome is presented in Table 2.

Table 2: Bounds Test for Cointegration Results

Variables	F-Statistics	Outcome	Decision
RGDP	3.311055	Inconclusive	Estimate short-run

Note: *Lower bound I(0) = 3.17 and Upper bound I(1) = 4.14; Lower bound I(0) = 3.79 and Upper bound I(1) = 4.85; Lower bound I(0) = 5.15 and Upper bound I(1) = 6.36 at 10%, 5%, and 1% levels of significance respectively.*
Source: Author's computations, 2024

The bound test of cointegration revealed that GDP growth rate as a response variable shows F-Statistics of 3.311055 which fall in between the lower bound I(0) and the upper bound I(1) for all the levels of significance, therefore, there is no cointegration. Thus, the null hypothesis of no cointegration is accepted, indicating the absence of a long-run cointegration relationship amongst the variables. This implied that RGDP and MC, TTV, and MT do not move together in the long-run. Therefore, the ARDL short-run relationship is estimated accordingly.

Table 3: ARDL Estimations

Variables	Coef.	Std. Err.	T	P>t
D(MC)	0.676956	0.138975	4.871056	0.0012
D(TTV)	-0.751891	1.017750	-0.738777	0.4812
D(MT)	0.354313	0.296234	1.196057	0.2659

Source: Author's computations, 2024

Table 3 provides the short-run coefficient estimates which indicates the dynamic adjustment of all variables incorporated in the study model. The result revealed that market capitalization

exhibited a positive and significant contribution to the real GDP. This implies that the increases in market capitalization translate into increased real GDP growth in the short-run. However, the total traded value and market turnover ratio failed to influence the real GDP. Therefore, the capital market indicators represented by total traded value and market turnover ratio could not meaningfully drive the economic growth process in Nigeria.

Discussion of Findings

In an attempt to evaluate the impact of capital market development on economic growth in Nigeria, this study developed a parsimonious model of economic growth using capital market development indicators as predictors. Thus, this study evaluated the proposition that capital market development can spur economic growth by testing the three hypotheses to find out if capital market proxied by Market Capitalization (MC), Market Turnover (MT), and Total Transaction Value (TTV) significantly influences economic growth proxied by gross domestic product (GDP) in Nigeria. The evidence of this study provided that among the dimensions of capital market development understudied, only market capitalization could significantly predict economic growth in Nigeria. This is as a result of the shallow market depth of the Nigerian capital market since the market is characterized by low liquidity and limited trading volumes. This shallow market depth hampers efficient price discovery and restricts the ability of the market to respond effectively to economic signals. Also, a few large companies dominate market capitalization and trading activity, leading to an unbalanced market structure. This concentration limits the diversity of investment opportunities and diminishes the market's overall impact on the economy. The Nigerian capital market seemed to be focused on short-term gains rather than long-term investments. This short-termism limits the market's ability to fund large-scale, long-term projects that can drive economic growth. Limited financial literacy accounts for the low market participation which contributes to market volatility and hampers economic growth.

Interestingly, some aspects of this research outcome contradict earlier scholars such Chikwira and Mohammed (2023); Itiveh and Okolie (2022); Okekwu et al. (2022); and Umar (2022) who found all dimensions of capital market development to influence economic growth significantly. However, for the market capitalization dimension, this study agrees with the aforementioned authors. Specifically, the outcome of this study agreed with Okekwu et al. (2022) who found market capitalization to contribute to Nigeria's GDP positively and concluded that the size of a capital market has a considerable beneficial impact on the economy in the long and short run.

Nevertheless, the outcome of this study finds support in the work of Toby and Dibiah (2021) and Muritala and Ogunji (2017) who arrived at a similar outcome as this study. For instance, Toby and Dibiah (2021) implemented the Vector Auto Regression (VAR) and found that the ratio of the value of stock to GDP is not significant in influencing the real GDP growth rate, while the market capitalization ratio to GDP significantly influences the GDP growth rate in Nigeria. Furthermore, Toby and Dibiah contend that the capital market is not the main driver of financial development and notwithstanding its size, the illiquidity of the market impedes its potential to drive economic growth.

Therefore, this study established that even though the size of the Nigerian capital market represented by market capitalization stimulates economic growth, the capital market in Nigeria is yet to be fully developed to confer enormous benefits on the economy. At the moment the benefits accruing from the market are skewed and narrow.

CONCLUSIONS AND POLICY IMPLICATIONS

This study established that the size of the Nigerian capital market mirrored through the market capitalization remained an important factor in the Nigerian economic growth process even though the Nigerian capital market is still developing and yet to achieve its full potential. Thus, the outcome of this study has contributed to the empirical debate that market capitalization drives economic growth. The study highlighted the need to improve the capital market in Nigeria to appropriate its benefits fully. This is because the outcome of this study revealed that the level of activity in the Nigerian capital market and its liquidity is low thereby having minimal impact on the economy. The implication is that raising necessary funds for business development will be difficult, and this will stunt the growth of businesses and their contribution to the economy. An inefficient capital market would stifle access to long-term funds for expansion, innovation, and modernization. This limits industrial diversification and modernization efforts, reducing overall economic productivity. Also, the funding gap for infrastructure development widens as a result of the inability of the market to mobilize funds for large-scale infrastructure projects leading to over-reliance on government funding and thus, slow infrastructure development.

Therefore, positioning the Nigerian capital market to drive economic growth requires comprehensive and coordinated efforts to boost the market depth and enhance its liquidity. This includes encouraging the listing of more firms especially from diverse sectors, by offering tax incentives, reduced listing fees, and streamlined listing requirements. The development of secondary markets for trading securities to enhance liquidity is another step that will improve the market. Also, improving the accessibility of the Nigerian capital market to foreign investors by aligning with international standards and practices would enhance the market's depth and potential to drive economic growth. The Nigerian capital market can leverage on fintech innovations to improve market access, efficiency, and inclusiveness. This includes digital platforms for trading, mobile banking, and blockchain technology for secured transactions.

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