

# THE CONTRIBUTIONS OF CAPITAL MARKET TO ECONOMIC DEVELOPMENT IN NIGERIA

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## ABSTRACT

*Virtually all aspects of human endeavor entail the use of money either self-generated or borrowed. In capital market, the stock in trade is money which could be raised through various instruments under well governed rules and regulations carefully administered and followed by different institutions or market operators. Economic development is a process by which a high degree of self-reliant economic growth in a given society is sustained over a given time. It is associated with substantial reduction on poverty and unemployment levels, and income inequality. This paper examines the concept of capital market, the concept of economic growth and economic development, relationship between economic growth and development, factors that determines economic growth and development, framework of regulating the capital market, highlight of recent reforms in the capital market, the contributions of capital market to economic development in Nigeria*

**Keywords:** *Capital market, economic development, regulations, contributions*

## INTRODUCTION

A capital market is a segment of a nation financial system where the main article of trade is medium and long-term financial instruments. Such instruments are generally referred to as securities because of the level of confidence and assurance or guarantee it gives to the investor on the repayment of their principal. It is true that the rate of economic growth of any nation is inextricably linked to the sophistication of its financial market and specifically its capital market efficiency. Financial markets assist the nations of the world to muster needed financial resources and skills for growth and development of their various economies.

According to Adebisi (2005) Equity markets in developing countries until the mid-1980s generally suffered from the classical defects of bank dominated economics that are shortage of equity capital, lack of liquidity, absence of foreign institutional investors, and lack of investor's confidence in the stock market. The importance of capital market lies in its financial intermediation capacity to link the

deficit sector with the surplus sector of the economy. The absence of such capacity robs the economy of investment and production of goods and services for societal advancement. Akingbougbe (1996) states that funds could thereby be idle at one end, while being sought at the other end in pursuit of socio-economic growth and development. The funding requirement of corporate bodies and government are often colossal, sometimes running into billions of naira. It is therefore, usually difficult for those bodies to meet such funding requirement solely from internal sources, hence they often look-up to the capital market. It's because the capital market is the ideal source as it enables corporate entities and government to pool monies from a large number of people and institutions. Thus, the socio-economic function of the capital market is well established. "It does not only encourage and mobilize savings but also efficiently allocate such savings to areas of need" (Ekineh, 1996).

The Nigeria capital market is sub-divided into primary and secondary markets. New securities are issued in the primary market and companies issuing these securities receive the proceeds for the sale. The secondary market provides a forum for the sale of existing securities by one investor to another investor. Thus, the efficient functioning of the market paves way for the primary market by making investors more willing to purchase new securities in anticipation of selling such in the secondary market. These securities are the major instrument used to raise funds at the capital market. In Nigeria, Capital market came into being as a result of the recommendation of the committee constituted in 1958 by the Federal Ministry of Finance, Commerce and Industry; the Lagos Stock Exchange (LSE) was registered under the Business Name Act in 1959 and incorporated in September, 1960 under the Companies Act as a company limited by guarantee. The Lagos Stock Exchange Act at 1961 established the Lagos Stock Exchange and it begins operation on 5th June 1961 in Lagos.

Capital issue commission becomes the apex regulatory body in the capital market as a result of capital issue Act enacted in 1973. The Securities and Exchange Commission (SEC) as the apex regulatory/supervisory authority in the capital market was established by the Securities and Exchange Commission Act of 27th September, 1979 and was re-enacted by the SEC Decree of 1988. Following the review of the capital market year-in year-out, a more elaborate statute was enacted in 1999 to replace the SEC Decree of 1988 to the newly enacted Investment and Securities Act No. 45 of 1999 (ISA).

The Structural Adjustment Programme (SAP) of 1986 deregulated the economy and launched the establishment of Second tier Securities Market (SSM) for mobilizing small savings and low companies which can not meet the requirement of First tier Securities Market. The Central Securities Clearing System (CSCS) was incorporated in 1992 as part of efforts to make the Nigerian stock market to be more efficient and investors friendly. Electronic processing of shares issue introduced by SEC in 2004 replaced the issuance of physical certification for script dividend has also helped the market to grow.

The capital market has been performing remarkably well with improvement in market capitalization, index, trading value etc. However, the recent global economic downturn has rocked the market which forced share price to move southward, and consequently made some investors lose confidence in the market but however some measures are being taken to control it by the federal government, Central Bank of Nigeria and other government agencies

### **THE CAPITAL MARKET**

Capital market according to Akingbongbe (1996) is a market where medium to long-term finance can be raised. In another exposition, Ekezie (2002) notes that capital market is the market for dealings (that is, Lending and Borrowing) in longer-term loan-able funds. The development of the capital market and apparently the stock market provides opportunities for greater funds mobilization, improved efficiency in resource allocation and provision of relevant information for appraisal (Inanga and Emenuga, 1997). Mbat (2001) describes capital market as a forum through which long-term funds are made available by the surplus to the deficit economic units. It must, however be noted that although all the surplus economic units have access to the capital market, not all the deficit economic units have the same easy access to it. The restriction on the part of the borrowers is meant to enforce the security of the fund provided by the lenders. In order to ensure that lenders are not subjected to undue risk, borrowers in the capital market need to satisfy certain basic requirement. Companies can finance their operations by raising funds through issuing equity (ownership) or debenture bond. Securities are structured to mature in period of years from the medium to the long-term of usually between five and twenty-five years.

Capital market offers access to a variety of financial instruments that enable economic agents to pool, price and exchange risk. It encourages savings in financial form. This is very essential for government and other institutions in need of long-term funds and for suppliers of long-term funds (Nwankwo, 1991). Based on the relevance of market in accelerating economic growth and development, government of most nations tends to have keen interest in the performance of its capital market. The concern is for sustained confidence in the market and for a strong investor's protection arrangement. In Nigeria, Securities and Exchange Commission (SEC) is the government agency responsible for developing and regulating the Nigerian capital market. It was created by Act No. 71 of 1979 and re-named as Securities and Exchange Commission Decree No. 29 1988. The SEC pursues its objectives by registering all market operators based on capital adequacy, competence and solvency as criteria. Generally, the capital market among other things provides a platform for the greater percentage of the populace to participate in the economy. In some countries, the capital market constitutes one of the largest sources of funds for the public and private sectors to finance importance projects. Similarly, the market provides a platform for mergers and acquisitions for companies desiring to do so while venture capitalists also use it as an avenue for promoting venture capital development.

## **ECONOMIC GROWTH AND ECONOMIC DEVELOPMENT**

According to Anyanwuocha (2008), economic growth is the process by which national income or output is increased. An economy is said to be growing if there is a sustained increase in the actual output of goods and services per head. The rate of economic growth therefore measures increase in real national income, during a given period of time, usually a year, while Economic Development is not the same as economic growth. It means more than mere growth of the economy (in terms of increased output). It is the process of increasing real per capital income and engineering substantial positive transformations in the various sectors of the economy. The positive changes which take place improve the general well-being of the people and ensure a sustained rise in the standard of living of the masses. Dare (2003), Defines economic development as a process by which a high degree of self reliant economic growth in a given society, sustained over a given time is associated with substantial reduction on poverty and unemployment levels, and income inequality.

### **Relationship between Economic Growth and Development**

According to Anyanwuocha (2008), although the two concepts do not mean the same thing, there is relationship between them. Inevitably, increased economic growth would in the long run lead to economic development. Although economic growth does not by itself guarantee economic development, it makes economic development possible. Economic growth enables improvements or positive changes to take place in various areas of economic activity due to the increased production of goods and services. Economic growth will inevitably lead to economic development provided the following conditions are fulfilled.

- i. Increased production of goods and services is not frustrated by rapid increase in population size.
- ii. There is an equitable distribution of the goods and services among individuals and areas.
- iii. The increasing level of production does not lead to mass unemployment as a result of using just a few labour-saving devices.

### **Determinants of Economic Growth and Development**

According to Dare (2003) for an economy to be growing or developing certain things are required. Below are some of the factors determining the economic growth and development;

***Resources Endowment and Utilization:*** These resources could be physical or natural resources and human resources. Physical or Natural resources include minerals and oil resources, fertile land, water resources, the landscape which provides sites for buildings, roads and other structures; air and everything that constitutes the atmosphere which is essential to life. Human Resources refer to the size and productivity of the labour available in a country, its managerial capabilities, and the technical skill acquired by the labour force.

***Capital Accumulation:*** This refers to an increase in capital stock of a country which

may be due to any or a combination of physical, financial and human capital as follows:

- i. Investment in new factories and industries make it possible for greater national output and income to be achieved.
- ii. Investment in social and economic infrastructures such as constant electronic supply, pipe borne water, banking institutions, communication network etc.
- iii. Investment in human capital, which may take the form of formal and informal education, vocational and on-the job training programmes, which improve human skill and labour productivity.

**Technology Progress:** This refers to advancements in the methods of production. This can come in the form of computerized banking operations, mechanized farming implements, and advanced use of machines in industrialization.

Improved technology can add to growth rate with no, or minimal addition to factor inputs. This makes production more efficient and also reduces cost of production by either increasing output with given input of resources or producing same output with lesser inputs.

#### **FRAMEWORK OF REGULATING THE CAPITAL MARKET**

According to Esosa (2007), the Securities and Exchange Commission (SEC) is the apex regulatory/supervisory authority in the capital market. It was established in 1979 by the Securities and Exchange Commission Decree, this decree was re-enacted in 1988, as Securities and Exchange Commission Decree No. 29 of 1988, for the purpose of protecting the investors as well developing the capital market. A detailed review of the Nigerian capital market was carried out in 1996. This led to the enactment of the Investment Securities Act (ISA) No. 45 of 1999 (and the regulation made there under). This Act replaced the Securities and Exchange Commission Decree No. 29 of 1988. It aims at providing a more efficient and viable capital market positioned to meet the country's economic and developmental needs.

**The Securities and Exchange Commission (SEC):** The Investment and Securities Act of 1999 Section (1) established the Securities and Exchange Commission (called the Commission or "SEC") as a body corporate with perpetual succession and a common seal. The commission can sue and be sued in its corporate name and may acquire, hold or dispose any property, movable or immovable for the purpose of carrying out any of its function under the Act.

#### **Composition of the Commission Section 2 (1), (2), (3) and (8) of ISA**

For purposes of carrying out its responsibilities under the Act, the Commission consists of:

- i) A Chairman;
- ii) One person not below the rank of Director to represent the Central Bank of Nigeria;

- iii) One person not below the rank of Director to represent the Ministry of Finance;
- iv) Two full time Commissioners who must be persons with ability, experience and specialized knowledge in capital market matters;
- v) The Director-General of the Commission; and
- vi) Five other Commissioners who must be persons with proven ability and expertise in corporate matters generally.

The Chairman and the Commissioners are appointed by the Head of State, Commander in Chief of the Armed Forces, on the recommendation of the Minister. Apart from the Director-General and the two full - time Commissioners, the other members of the Commission are part-time members.

### **HIGHLIGHT OF RECENT REFORMS IN THE CAPITAL MARKET**

To a large extent, the recent reform of the capital market started with the enactment of the Investment and Securities Act (ISA) No. 45 of 1999 which replaced the SEC decree of 1988. The ISA enlarged the powers and functions of the Securities and Exchange Commission for the attainment of a more efficient and virile capital market that would meet the needs of the economy as discussed in this work previously. Other reforms that have taken place in the capital market include;

- i. Review of minimum capital requirement for operators.
- ii. Reduction of transaction costs.
- iii. Introduction of a code of corporate governance.
- iv. Reactivation of the bond market.
- v. Introduction of shelf registration.
- vi. Development of a commodity markets.

Al-Faki (2007) continues in his statement that some of these reforms and their benefits on the capital market are:-

**Review of Fees:** The SEC recently took steps to reduce the cost of doing business in the market in its efforts to make the market internationally competitive and investor friendly by authorizing a 40% downward review of fees and commission charged. This is aimed at making the market attractive to participants.

**Recapitalization of Capital Market Operation:** To make operator contribute more to the growth of the real sector, the minimum paid-up capital base has been reviewed upwards. Issuing houses capital requirement moved from N150million to N2billion; Broker dealers from N70million to N1billion; Clearing and Settlement agencies from N500million to N1million and registrar from N500million. Underwriters, who before now had a minimum capital base of N100million, are now required to have N2billion; Fund/Portfolio manager from N20million to N500million; while corporate sub-brokers with a current base of =N= 50million. The recapitalization of operators in the capital market is to strengthen them financially for informational competitiveness and more importantly to match their exposure.

**Introduction of Market Makers:** An on-going development in the Nigerian capital market is the introduction of market makers, whose minimum capital base is fixed at N2billion. The commission is currently collaborating with the NSE to introduce primary dealer market makers for the equity sector of the market. This is in addition to the market makers who already operate in the bond sector. The infrastructure for stock lending and borrowing is also being fine-tuned to pave way for take-off of these measures so that markets would be more vibrant and liquid; thereby making its role of financial intermediation more efficient

## **AN ASSESSMENT OF THE NIGERIAN CAPITAL MARKET**

According to Goddy (2008), the Nigerian Capital Market would be examined using a number of variables. The variables include:

**Equity Market Capitalization:** These measures the amount of wealth held in securities and it is an indication of the financial base of the market. The market capitalization of the NSE has been rising steadily. It was N1,926,462.10trillion in 2004. But as at 2007 it was N13.294trillion and as at March 5, 2008 before the world economic Crunch it stood at N12.640trillion.

**Trading Value and Liquidity:** It indicates the level of activities that is, the rate at which securities are bought and sold as well as its liquidity. It dropped by 50.52% at January 2009.

**All Share Index:** It started with an index value of 100 in 1984 with increase listings and financial activities. It attained 58,580 in year 2008 and went on to achieve its highest value ever of 66,371 on March 5, 2005.

**Market Infrastructure:** The introduction on CSCS by the NSE has enhanced the efficiency of the market. The introduction of new clearing and settlement period has improved transparency and brought the stock market in line with internationally acceptable standards. Transaction day plus 3 (T+3) is what is currently operating by for clearing and settling.

## **THE CONTRIBUTIONS OF CAPITAL MARKET TO ECONOMIC DEVELOPMENT IN NIGERIA**

Anao (1994) also noted that the Nigerian economy has since benefited from the capital market in the following ways:

**Cash:** Enormous sums could be raised on the capital market without the limitations associated with bank financing. For instance, no single bank would have given Edo State Government the N1billion it raised from the market in 2004; not even a loan syndication would have provided the kind of comfort the banking industry would have required considering credit rules and safety considerations.

**Liquidity with Employees:** For enterprises, employees could be offered incentive through stock options. The underlying benefit is the hope that someday the company will go public and employees would be able to exercise their stock options to create wealth for themselves.

**Liquidity for Investors:** Creating a public market for a stock, raising funds on the capital market through stock exchange listing result in liquidity for investors.

**Marketability of Shares:** Quotation on the stock exchange increase marketability of the shares. An issued security can be traced and valued easily and can also be used as collateral for bank loans. This greatly increases the potential on the business and personal benefit to its owners.

**Continuity:** For an enterprise, the survival and the continuity of a company based on the exchange is guaranteed after the death of its founders.

**Public Confidence:** A company quoted on the exchange enjoys greater confidence from its investors and the banks. Bank managers find it easier to offer credit to a quoted company than to an unquoted one.

**Sharing Risk and Retaining Control:** There is opportunity for existing shareholders to share part of their investment risks while still retaining control of the company.

**Expansion and Modernization:** Proceeds from the issue can be used for expansion and modernization of the company.

Finally, the economic significance that will accrue to state and local governments which patronize the capital market are many. Some of which are;

- i. More capital projects can be completed as more resources are available for government capital expenditure.
- ii. There will be better accountability for use of funds as statutory financial market.
- iii. Rising of funds from the capital market will release government subvention for purely social project.

Conclusively, the tendency to spend money on "white elephant project" will be curtailed as only economically viable projects could be financed from the capital market.

Table 1: Indicators of Capital Market Development (trend in the market capitalization and NSE Value Index)

Indicators	2008	2007	2006	2005	2004
No. of Listed Securities	299	310	288	288	277
Vol. of Stocks Traded (T/Volume) =N='Billion	193.14	138.1	36.5	26.7	19.2
Value of Stocks Traded (T/Value) =N='Billion	2.4trn	2100.0	470.3	262.9	225.8
Value of Stocks/GDP (%)	10.4	9.2	2.5	1.8	1.9
Market Capitalization =N='Trillion	9.56	13.29	5.12	2.90	1.93
Market Cap. / GDP (%)	40.1	58.2	27.6	19.5	16.5
Annual T/Volume/Value of Stock (%)	8.0	6.6	7.8	10.1	8.5
Annual T/Value/Market Cap. (%)	25.1	15.8	9.2	9.1	11.7
NSE Value Index (1984 = 100)	31,450.78	57,990.22	33,358.3	24,085.8	23,844.9
Growth in Percentage					
No. of Listed Securities	(3.5)	5.8	0.0	4.0	4.5
Volume of Stocks	39.9	276.3	36.8	38.8	44.4
Value of Stocks	142.9	343.7	78.9	16.4	87.6
Market Capitalization	(28.1)	159.6	76.6	50.6	45.4
Annual Turnover Value	142.9	343.7	78.9	16.4	87.6
NSE Value Index	(45.8)	74.7	38.5	1.0	18.5

**Source:** CBN Annual Reports and Statement of Accounts for Various Years.

The statistical table computed above revealed to us that the total market turnover was largely driven by the portfolio re- alignment elicited by the Banking Sector return and the general decline in interest rates. Turnover on the Exchange close the year at N262.9Billion up by 16.4 on the N225.8Billion recorded in 2004. In 2005, the market capitalization increased by 5.2% to end the year at N2.9Trillion. The listing of new securities (equities and bonds) contributed in large part the growth of the market capitalization during the year.

The NSE All-Share Index rose marginally by 1.01% to close the year at 24,085.76. However, on 10th October, 2005 the index had attained its 2005 highest value of 26,221.90 before dropping to its year position. In 2006, the total market value of 288 securities listed on the Exchange increased by 78.9% to stand at N5.12trillion by year end. The Nigerian Stock Exchange All-Share Index rose by 37.2 % to close the year 2006 at 33,358.30. This is an improved performance, compared with the marginal growth of 1.0% recorded in 2005. The performance of the All-Share Index indicated an improvement in prices of quoted stocks during the year. Also, the market contribution to the GDP rose from 19.5 per cent to 27.6 per cent as a result of market capitalization growth and improvement in 2006.

In 2007, the trend continues when the Market Capitalization of 310 securities listed closed at N13.29trillion compared with N5.12trillion in 2006. A combination of new listings, supplementary issue and price appreciation in the equities sector accounted for the much growth in market capitalization. The market all improved tremendously with major indices closing the year on very strong note. During the year under review the Market Return 74.73 % or 24,800.92 points to close the year 2007 at 57,990.22 points against 33,189.30 in 2006 which it opened. This performance of the index reflects positive improvement in prices of most quoted equities during the year especially the highly capitalized stocks.

The major capital market development indicators showed significant improvement when the market contribution to the GDP rose from 27.6 per cent to 58.2 per cent in 2007. The total market value of 299 securities listed on the exchange in 2008 dropped by 28.1% from N13.29trillion to N9.56Trillion at year end 2008. The turnover on the exchange closed the year at N2.4trillion or 10.4% of GDP up by 1.2% on the N2.1trillion (9.2 of GDP) recorded in 2007. The decline in market capitalization resulted from price depreciation of equities and non-admission of new securities in the federal government development stocks, state governments' bonds etc. during the year 2008. The NSE All-Share Index dropped by 45.8 % or 26,539.44 points to close at 31,450.78, a reversal of the record-setting growth of 74.73% recorded in 2007. The index closed at 57,990.22 in 2007. The Index had on March 5, 2008 recorded an historic value of 66,371.20 before dropping to its year-end level.

## CONCLUSION

Capital market has a great impact on the development of Nigeria economy; it promotes an efficient and provides opportunities for investment diversification. The improved delivery and settlement processes has reflected positively on the liquidity of the capital market, as well as put the Nigerian stock market on the same pedestal with some of the leading international stock exchanges. The automation of the clearing, depository and settlement system and the transition to Automated Trading System (ATS) have enhance the opportunity for price discovery in our market and raised overall market efficiency. In the same vain, automation has made our capital market truly international and emerging market, giving the nation a strong and dynamic capital market, which can be relied upon by foreign investors for efficient portfolio management. Government should therefore strive at all times to secure a stable macro-economic and political environment based on the formulation and implementation of policies, which are consistent with the development objectives of the nations; it should pursue investor - friendly policies and ensure a level playing field for all participants in the market.

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