

ABSTRACT

The stock market is a common feature of a modern economy and it is perceived to perform some necessary functions which promote the growth and development of the economy. Hence, deliberate effort has been made by various nations, especially those of the developing world to develop their stock markets as a means of achieving economic growth. This study examines whether the development of the Nigerian Stock Market promotes economic growth in Nigeria over the period of 1981 –2008.

To achieve this objective, time series data on some notable stock market development indicators for the study period were obtained from secondary sources. The study employed the ordinary least squares (OLS) and the co-integration estimation techniques. However, attention was focused on the co-integration results, given that it allows us to make appropriate policy implications on the relationship that exists between time series variables which may be non-stationary.

With a 98 percent R-squared and 96 percent R-squared adjusted, the result of the study revealed that economic growth is adequately explained by the model for the study period. Moreover, the study established that, a positive but non-significant relationship exists between some notable stock market indicators used – market capitalization ratio, turnover ratio, new issues – and economic growth.

This study suggests the pursuit of policies geared toward improving and rapidly developing the Nigerian stock market as a way of expanding its contribution to economic growth. The study also calls on all sectors of the economy to act in a collaborative manner such that the optimum benefits of linkages between stock market and economic growth can be realized in Nigeria.

TABLE OF CONTENTS

Title page	i
Certification	ii
Dedication	iii
Acknowledgement	iv
Abstract	v
Table of Contents	vii

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study	1
1.2 Statement of Research Problem	9
1.3 Objectives of the Study	12
1.4 Hypothesis of the Study	13
1.5 Significance of the Study	13
1.6 Scope of the Study	15

1.7Limitations of the Study	16
CHAPTER TWO: LITERATURE REVIEW	
2.1Conceptual Issues	17
2.2Stock market development and economic growth	24
2.3Overview of the Nigerian Stock Market	35
2.4Evaluation of the growth/performance of theNigerian Stock Market	46
2.5Challenges and Prospect of the Nigerian StockMarket	89
CHAPTER THREE: THEORETICAL FRAMEWORK AND METHODOLOGY	
3.1Theoretical Framework	96
3.2Model Specification	103
3.3Data Sources	105
3.4Method of Analysis	106
CHAPTER FOUR: DATA PRESENTATION AND ANALYSIS OF RESULT	
4.1Presentation of Data	107
4.2Presentation and Analysis of Result	110
4.3Policy Implication	125
CHAPTER FIVE: SUMMARY, RECOMMENDATIONS AND CONCLUSION	
5.1Summary	129
5.2Recommendations	132
5.3Conclusion	136
References	138

CHAPTER ONE INTRODUCTION

1.1BACKGROUNDTO THE STUDY

Themobilization of resources for national development has long been the crucialfocus of development economists. This isbecause, for sustainable growth and development to take place, funds must beeffectively mobilized and allocated to enable business and the economyharnesses their human, material and managerial resources for optimaloutput. It is against this backgroundthat every country has a financial system which serves as a mechanism for themobilization of resources for the attainment of economic growth. Consequently,the more developed the financial system of an economy is, the more efficient itis likely to be in the mobilization and allocation of resources for developmentpurposes.

Thefinancial system of any society is the framework within which capital formationtakes place. According to Odife (1994),it is the framework within which the savings of some members of the society aremade available

to other members of the society. Put differently, it is the arrangement or mechanism by which the savings surplus units of the economy transfer their resources to the borrowing deficit units for the purpose of enhancing economic growth (Okereke – Onyiuke, 2009). The financial system is made up of two major markets. These are the money market and the capital market. According to Elakama (2009), the two markets are at the heart of the financial system.

The money market is a type of market where short term funds and securities such as treasury bills, inter-bank deposits, Banker's acceptance, certificate of deposits etc whose tenor are usually shorter than or equal to a year are bought and sold. In other words, it is a market where short term capital is sourced. The capital market on the other hand is a type of market where long term debt instruments whose tenor exceeds a year are traded. According to Sulaiman (1999), it is a network of interrelated institutions governed by operational guidelines, which permit the sale of equity and long term debt. Furthermore, Al-Faki (2006) describes the capital market as a network of specialized financial institutions, series of mechanism, processes and infrastructure that, in various ways, facilitate the bringing together of suppliers of medium to long term capital for investment in socio-economic development projects. Instruments traded in the capital market include equities, debts, government bonds, corporate bonds, preference shares, debentures, rights etc.

Within the broad classification of the capital market is the stock market, which operates as the rallying point for the overall activities in the capital market. According to Alile and Anao (1984), the stock market is the pivot around which every activity in the capital market revolves. It follows therefore that without the facilities provided by the stock market, it is doubtful if the capital market can efficiently perform its expected role of resource mobilization (Ologunde, Elumilade and Asaolu, 2006). It is in the light of the above that the stock market is considered a vital element in the mobilization and allocation of resources in any modern economy. Until now, the literature has mainly focus on the role of financial intermediation in the process of economic growth and capital accumulation. Indeed, many studies have analyzed the channels through which banks and other financial intermediaries may help to increase, for example, the savings rate or the average productivity of capital and, in turn growth. Recently, however, with the upsurge in world stock markets and with a large proportion of this boom accounted for by emerging markets, there has been a growing interest among economists and policy makers on the role played by stock market development in the process of economic development. Recent research has therefore begun to focus on the linkage between the stock market and economic development. It is no wonder, that the World Bank Economic Review dedicated its May 1996 issue to the role of the stock market in economic growth.

The stock market also known as the stock exchange or equity market performs some functions that promote the growth of the economy (Osinubi, 2004). Firstly, as an economic institution, the stock market promotes efficiency in capital formation and allocation. Secondly, the stock market serves as a veritable tool in the mobilization and allocation of savings among competing uses which are critical to growth of the economy. Thirdly it enables governments and industry to raise long term fund for financing new projects and expanding and modernizing industrial/commercial concerns, thereby increasing the quantity and quality of investment. Fourthly, by performing its function of allocating capital efficiently, the stock market, as it mobilizes savings concurrently allocates a larger proportion of it to the firms with relatively high prospects as indicated by their rate of returns and level of risk. The importance of this function is that capital resources are channeled by the mechanism of the forces of demand and supply to those firms with relatively high and increasing productivity, thus enhancing economic expansion and growth. Additionally, the stock market performs the functions of intermediating between the needs of firms and investors; providing a means of sharing investment risks; providing information about companies, promoting and providing the means of improving corporate governance etc. Furthermore, well functioning stock market provides low cost equity capital for firms imposes control on the investment behaviour of firms through continuous adjustment of shares and serves as a mechanism for attracting foreign portfolio investment. Given the above functions, it is expected that the development of the stock market will both enhance and lead to growth of the economy.

In recognition of the importance of the stock market in economic development, many developing countries have launched stock exchanges during the past few decades. This explains the drive toward the establishment of stock exchanges in African countries especially during the past two decades, with new stock markets established in Ghana, Malawi, Swaziland, Uganda and Zambia. Prior to 1989, there were just eight stock markets in Africa, of which three were in North Africa and five in Sub-Saharan Africa. At present, more than 50% of the fifty four African countries operate stock exchanges, accounting for over twenty-two stock exchanges in Africa (Komo, 2008). According to Komo, this rapid expansion of stock exchanges in Africa has contributed to economic development in various ways, which amongst others include facilitating the privatization process, diversifying the financial services, facilitating long term capital mobilization, provision of alternative investment opportunities, attracting capital inflow and serving as a signal of overall macroeconomic performance.

Aware of the crucial role played by the stock market in any modern economy, the Nigerian government in 1960 established the Nigerian Stock Exchange (NSE). Like many African countries, Nigeria has invested in

developing her stock market as a means of providing opportunities for greater fund mobilization and improved efficiency in resource allocation. This study therefore examines whether stock market development promote growth in Nigeria.

1.2 STATEMENT OF RESEARCH PROBLEM

The role of a developed stock market in the development of any economy cannot be over emphasized in view of its potentials and likely impact on the economy if well harnessed. It is a known fact that nations cannot develop without the needed long term funds for development projects, and the more developed a stock market is, the higher the potential for sourcing long term fund for industrialization. Indeed, as pointed out by Osinubi, a well functioning stock market serves a veritable tool in the mobilization and allocation of resources needed to meet the rapid expansion of the economy as it develops.

Over the years, the Nigerian Stock market has experienced relative stability and recorded impressive growth. This growth has been most significant especially since the introduction of the Structural Adjustment Programme (SAP) in the early 1980s, which brought about the privatization, commercialization and liberalization programmes, all of which has helped in boosting activities in the stock market. However, as noted by Ogwumike and Omole (1997), when compared with other emerging and developed markets, it becomes evident that the Nigerian Stock Market is still relatively small in size and underdeveloped. For example, a comparison of the Nigerian Stock Market in terms of number of listed equities reveals that while Nigeria has only 214 equities listed in 2005, even though its stock exchange was established in 1960, Singapore has over 500 (established in 1979), Hong Kong 695 (established in 1986) and Istanbul over 900 (established in 1986). This thus indicates the relative poor performance of the Nigerian Stock Market vis-à-vis those of other countries. Moreover, Osazee (2007) pointed out that less than 21 percent of the 400,000 registered companies in Nigeria are not currently quoted on the Nigerian Stock Exchange, a situation which he attributes to the unattractiveness of the market as well as the lack of incentives for more companies to go public. Furthermore, while the growth of the stock market has been impressive, same cannot be said of the growth of the Nigerian economy.

In recognition of the above, the research questions for this study are:

- i. Has the growth of the Nigerian Stock Market promote economic growth in Nigeria?
- ii. Has the market acted as a mechanism for attracting foreign capital inflow?
- iii. How has the market facilitate the mobilization of long term fund for financing long term development project?

1.3 OBJECTIVES OF THE STUDY

The stock market is a common feature of a modern economy and it is reputed to perform some functions that promote the growth and development of the economy. Given the above, this study is therefore carried out primarily to empirically ascertain the impact of the Nigerian Stock Market on economic growth. Specifically, the objectives are:

- i. to identify the channels through which the stock market impacts on economic growth;
- ii. to examine the establishment of the Nigerian Stock Market, as well as its performance and growth;
- iii. to identify the performance/growth drivers of the Nigerian stock market;
- iv. to identify the challenges facing the Nigerian Stock market and examine various ways of boosting its performance and growth.

1.4 HYPOTHESES OF THE STUDY

A research hypothesis is a scientific statement expressing the relationship between two or more variables which is meant to be tested. In the light of the primary objective of this study, the following hypotheses have been formulated

1. **H₀:** The development of the Nigerian Stock Exchange is not positively associated with economic growth in Nigeria.
2. **H₁:** The development of the Nigerian Stock Exchange is positively associated with economic growth in Nigeria.

1.5 SIGNIFICANCE OF THE STUDY

The significance of an efficient and well functioning stock market in spurring economic growth has been well emphasized in the literature. Therefore, a constructive and objective study of the stock market which aims at highlighting its role in the process of capital formation and national development will be of great importance both to individual investors, firms and policy makers.

As a market place where securities (Stocks, bonds, shares) are bought and sold openly with relative ease, the stock exchange is very important to investors. Hence, prospective share holders and investors would find the work relevant as the research study focuses on the Nigerian Stock Exchange where activities of the capital market are usually carried out. Furthermore, since the stock market is a reliable means through which firms can source for low equity capital, as well as the fact that the prices of the stocks of firms quoted on the stock exchange serves as an indication of the overall performance of the firm, this research study will also be of great significance to firms. Additionally, this research will be relevant to the

government as it will enable it have a better knowledge of the policies necessary to enhance or improve the contribution of the stock market to the economy.

This research work will also serve as a reference for subsequent write-ups and stimulate further in-depth and insightful study in this area of study.

1.6 SCOPE OF THE STUDY

In view of its primary objective, this study focuses mainly on the activities of the Nigerian Stock Market without detailed reference to other markets in the capital market. The study covers activities of the Nigerian stock market for a period of 28 years, from 1981 to 2008. The choice of this period is anchored on the fact that it covers both the relatively small and high activities performance of the market.

1.7 LIMITATIONS OF THE STUDY

This research was limited by certain constraints which include difficulty in sourcing data from certain relevant organization, non availability of data on certain variables, restrictions on accessing certain materials on the internet and insufficient financial resources for the study.

Lastly, this study was also constrained by inadequate time on the part of the researcher, since attention had to be given to other course work.

AN ANALYSIS OF THE IMPACT OF STOCK MARKET DEVELOPMENT ON ECONOMIC GROWTH IN NIGERIA

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